PENSION EQUITY TAX ACT OF 1982

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 6410

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE GREATER EQUITY IN, AND TO PREVENT ABUSE OF, THE TAX TREATMENT OF PENSIONS AND CERTAIN OTHER BENEFITS

JUNE 10, 1982

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PENSION EQUITY TAX ACT OF 1982

THURSDAY, JUNE 10, 1982

House of Representatives,
Committee on Ways and Means,
Washington, D.C.

The committee met at 10:05 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

Chairman Rostenkowski. I would like to announce for our guests and the members that it is the intention of the Chair to work through lunch today, and to conclude all testimony this afternoon.

The purpose of today's hearing is to receive testimony from the administration, major interest groups, and public witnesses on H.R. 6410, the Pension Equity Tax Act of 1982, introduced by our distinguished colleague from New York, Mr. Rangel.

It is the hope of all members of the committee that the House of Representatives will adopt a budget this week, and that a conference committee will promptly approve a passable first budget resolution.

At that time, the real work of the Committee on Ways and Means will begin. Whatever budget passes, it is a certainty that the committee will be required to find billions of dollars in increased revenues.

Pension tax reform has been on every list of proposed revenue increases during the budget negotiations of the "Gang of 17" earlier this spring.

Bob Dole, chairman of the Senate Finance Committee, has repeatedly stated that pension tax reform will be considered this year, as have administration officials who participated in the spring budget negotiations.

Therefore, I fully expect pension tax reform to be part of any revenue increase bill that may be developed by the tax-writing committees this year. With the introduction of H.R. 6410 and today's hearing, consideration of pension tax reform begins in the Committee on Ways and Means.

The revenue effect of legislation such as H.R. 6410 is important. However, there are other, important policy considerations in the pension area that are due for timely review.

In the midst of the budget turmoil, a policy forum must also be given to the appropriateness of current law: its equity, efficiency, cost, and effects.

The larger long-term budgetary picture, however, provides a proper frame of reference for undertaking this policy review. The tax expenditures of $26 billion a year associated with the private pension system must undergo the same rigorous scrutiny to which other Federal spending programs are being subjected.

H.R. 6410 brings these issues into sharp focus, and I believe that the committee, and the taxpaying public that underwrites this system, will be well-served by this review.

At this point, I would like to recess the committee, pending a vote that is taking place on the House floor. Immediately upon my return, we will hear the testimony of the Treasury Department.

[Recess.]

Chairman ROSTENKOWSKI. At this point, I would like to ask unanimous consent that the two press releases announcing today's hearing be included in the record. I also would like to call on the esteemed chairman of the Subcommittee on Oversight, Mr. Rangel, for his opening remarks.

[The press releases follow:]

[Press release of Friday, May 21, 1982]

HON. DAN ROSTENKOWSKI, CHAIRMAN, COMMITTEE ON WAYS AND MEANS, ANNOUNCES A 1-DAY PUBLIC HEARING ON H.R. 6410, THE PENSION EQUITY TAX ACT OF 1982, TO BE HELD ON TUESDAY, JUNE 8, 1982

The Honorable Dan Rostenkowski (D., Ill.), Chairman, Committee on Ways and Means, U.S. House of Representatives, announced today a hearing on H.R. 6410, the Pension Equity Tax Act of 1982, to be held on Tuesday, June 8, 1982. The hearing will begin at 10 a.m. in the Committee's main hearing room, 1100 Longworth House Office Building. The Committee expects the lead-off witness to be the Honorable John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy.

H.R. 6410, introduces on May 19, 1982, by the Honorable Charles B. Rangel (D., N.Y.), Chairman, Subcommittee on Oversight, Committee on Ways and Means, would make significant changes in a number of important sections of the Internal Revenue Code relating to employee benefit plans. As noted by Chairman Rangel in his introductory floor statement, the main objective of the legislation is to provide greater tax incentives for the comprehensive inclusion of the broadest class of employees in tax-subsidized pension plans and statutory fringe benefit plans. The introductory statement of Chairman Rangel and the section-by-section explanation of the Pension Equity Tax Act of 1982 may be found in the May 19, 1982, Congressional Record at page H2353.

1. MODIFICATIONS IN LIMITATIONS ON CONTRIBUTIONS TO CORPORATE PLANS

Under present law, tax-qualified defined benefit and defined contribution pension plans are limited with respect to overall annual contributions on behalf of each plan participant. Section 415 of the Internal Revenue Code limits contributions in the case of a defined contribution plan to the lesser of 25 percent of compensation or $45,475 per participant for 1982. Section 415 limits contributions in the case of defined benefit plans to the lesser of 100 percent of average compensation or $136,425 for 1982. Both the defined benefit and defined contribution plan limits are adjusted annually for the cost of living. In addition, present law provides that if the defined benefit plan provides benefits prior to age 55, the $136,425 limit is reduced to reflect the earlier retirement age.

H.R. 6410 reduced the section 415 contribution limits from $45,475 to $30,000 in the case of defined contribution plans and from $136,425 to $90,000 in the case of defined benefit plans. The annual COLA provided under section 415 would be repealed. The $90,000 limit would be reduced if retirement benefits under defined benefit plans are received before age 65 rather than age 55 (as under present law). In addition, the aggregate limit applied to a participant in both a defined contribution and defined benefit plan would be reduced from 140 percent to 100 percent of the otherwise applicable separate limits.

2. LOANS

Present law permits certain loans to be made by qualified pension plans to plan participants. However, under an H.R. 10, or Keogh, plan loans are not permitted to be made to owner-employees and loans from such plans for other self-employed individuals are treated as plan distributions to which the usual tax rules for distributions apply.

H.R. 6410 extends the present rule that treats loans from a Keogh plan as a distribution to all loans from qualified plans made to key employees.

3. INTEGRATION RULES

Under present law, qualified pension plans are permitted to take into account, or offset, the portion of each employee's social security benefits provided by the employer. Under the so-called integration rules promulgated by the Internal Revenue Service, an employee's annual pension benefit may be reduced by up to 83.33 percent of the social security primary insurance amount to which the employee is entitled. In the case of defined contribution plans, the Internal Revenue Service has determined that the employer's cost of providing social security benefits is 7 percent of the taxable wage base ($32,400 in 1982) and, accordingly, profit sharing plans may integrate up to this amount. In 1982, the social security (OASDI) tax rate on employers is 5.4 percent.

H.R. 6410 provides new rules for the nondiscriminatory coordination of private pension plans with social security.

4. KEOGH PLAN CONTRIBUTION LIMITS AND PROFESSIONAL SERVICE CORPORATIONS

Under present law, self-employed individuals are permitted to contribute to H.R. 10, or Keogh, plans the lesser of 15 percent of compensation or $15,000. These limits are generally lower than the overall limits which apply with respect to employees under qualified corporate plans. In addition, Keogh plans which cover an owner-employee (sole proprietor or over 10 percent partner) must meet additional special standards with respect to participation, vesting, distributions and integration. Due to the lower contribution limits, an increasing number of traditional sole proprietorships and partnerships have been incorporating as professional service corporations.

H.R. 6410 increases the deductible Keogh limits from $15,000 to $30,000 and extends the rules covering large self-employed plans (Keogh plans with no owner-employees) to professional service corporations.

5. NONDISCRIMINATION RULES FOR STATUTORY FRINGE BENEFITS

The Internal Revenue Service now provides favored tax treatment for a number of statutory fringe benefits, the cost of which is generally excluded from an employee's gross income. These benefits range from life and health insurance to van pooling plans. Different rules prohibiting discrimination apply with respect to each type of plan. If a plan is determined to discriminate in favor of certain officers, shareholders or highly compensated employees, the otherwise applicable income exclusion generally is denied for all benefits paid under the plan.

H.R. 6410 provides for a new, uniform nondiscrimination standard for most statutory fringe benefit plans and limits the denial of the gross income exclusion in the case of discriminatory plans to key employees only.

6. LIMITATION ON ESTATE TAX EXCLUSION FOR ANNUITIES

Section 2039 of the Internal Revenue Code generally excludes from a decedent's gross estate employer-financed benefits paid to the beneficiary of a deceased employee under a qualified pension plan or tax-sheltered annuity. No dollar limit applies to these exclusions.

H.R. 6410 places a $500,000 cap on the estate tax exclusion for certain employer provided pension plan and tax-sheltered annuity benefits under Code section 2039.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Committee to hear as many points of view as possible. Time for oral presentation will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for Committee members to interrogate witnesses. The witnesses will be grouped as panels to expedite the hearing, and strict time limitations will be established for each panelist.

The following is an outline of the procedure to be followed by organizations and individuals who either may want to appear and testify during this hearing or file a written statement for the printed record of the proceedings. All requests should contain the following information:

1. The name of the witness, his title, address, firm affiliation and/or organization he will represent (as well as a telephone number where he or his designated representative may be reached).

2. If appearing in an individual capacity, a list of any clients at whose request or in whose employ the witness appears.

3. A topical outline or summary of comments and recommendations.

Request to be heard must be made by telephone to Harriett Lawler [telephone (202) 225-3627] by the close of business, Wednesday, June 2, 1982. The telephone request should be followed by a formal written request addressed to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House Representatives 1102 Longworth House Office Building, Washington, D.C. 20515.

Witnesses are required to submit 125 copies of their prepared statements to the Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their schedule appearances. Failure to comply with this rule may result in the witness not being allowed to testify.

WRITTEN STATEMENT IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing, five copies are required and must be received by the close of business, Friday, June 18, 1982. These statements should contain the information listed in #1-3 earlier in this press release, The statements should be delivered to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office during the course of the hearing.

[Press release of Tuesday, June 8, 1982]

HON. DAN ROSTENKOWSKI, CHAIRMAN, COMMITTEE ON WAYS AND MEANS, ANNOUNCES POSTPONEMENT OF PUBLIC HEARING ON H.R. 6410, THE PENSION EQUITY TAX ACT OF 1982, TO BE RESCHEDULED FOR THURSDAY, JUNE 10, 1982

The Honorable Dan Rostenkowski (D., Ill.), Chairman, Committee on Ways and Means, U.S. House of Representatives, announced today that the one-day public hearing on H.R. 6410 scheduled for Tuesday, June 8, 1982, would be rescheduled for Thursday, June 10, 1982, and that the Committee expects to receive testimony from the Department of the Treasury as well as from the public witnesses who were scheduled to be heard. The hearing will begin at 10 a.m. in the Committee's main hearing room, 1100 Longworth House Office Building.

Chairman **ROSTENKOWSKI**. Mr. Rangel is recognized.

Mr. **RANGEL**. Thank you so much, Mr. Chairman.

This year in an attempt to close the huge deficits and bring down interest rates, Congress will be considering both cuts in spending and increases in taxes. I believe this should be done with a greater degree of equity and fairness.

In the final analysis a tax expenditure is no more, no different than any other Federal spending program. I think Congress has an obligation to reexamine a number of tax expenditures to determine whether they are efficient, whether they meet the standards of fairness and equity.

One of the largest tax subsidies for individuals is the retirement income subsidy. It is estimated that in the 1982 fiscal year, the Federal tax subsidy for employee-provided retirement plans will be $25.8 billion.

While few would question the goal of encouraging retirement savings, it is my belief that the present limits results in the use of the tax laws far beyond the original goal of providing incentives for a secure retirement.

For example, in 1982, a defined benefit pension plan could pay an annual benefit of $136,425 to an employee for life. For 1982, you can contribute $45,475 to a profit-sharing plan for a single employee and the Treasurer in the United States and taxpayers will share in that cost.

What do these numbers mean? They mean the 35-year-old employee of his own company can accumulate over $12.5 billion for himself at age 65 in a combination of tax-free retirement plans.

The plans can provide the employee and his wife with an income in excess of $1.25 million each year for as long as he and she lives. Only when the funds are paid out will they be subject to tax.

The very same company can deduct over $56,000 each year to pay the employee's benefits and the employee pays no tax on them. For a long-term employee of his own company who is age 55 and waits until 1982 to set up a combination of plans, the rule means, as it exists today, that he deducts over $150,000 for 1982, just to fund his own benefits.

I think that the existing law, the present law, asks too much of the average taxpayer, who is paying the bill. Only about one-half of our work force participates in employer-sponsored retirement plans.

Many who participate receive no benefits and I think we will hear testimony to that effect today. These people and those with a modest pension are required by our tax laws to subsidize the few that take advantage of these rules.

This is not equity, but indeed, it is a waste of our resources. Our bill, H.R. 6410, reduces the limits on contributions of benefits under the plan, for the defined benefit pension plan, the limit would be an annual benefit of $90,000, additional—annual contributions up to $30,000 would be allowed under the profit sharing of the defined contribution plans.

Even after these changes, and other reductions that are provided in the bill, qualified plans will be able to provide very attractive benefits. The 35-year-old could still accumulate over $8 million instead of the $12 million and the 55-year-old could deduct over $74,000 a year.

The tax subsidies to qualified plans have been justified in the past, because these plans were supposed to be nondiscriminatory. They were not to provide a higher rate of contributions for benefits for highly paid employees than for the rank-and-file.

The idea is that the decisionmakers in these companies can enjoy substantial tax subsidies for their own retirement benefits, only if they provide retirement benefits for the employees in their work force.

While this is a very noble principle, in practice these plans have provided very handsome benefits for the decisionmakers while shortchanging the rank-and-file employees. They use a variety of techniques to do it, but the most important is integration with social security. Because the integration rules allowed plans too much credit for employer-provided social security benefits, the plan benefits for a low-pay worker can inappropriately be reduced or eliminated in spite of the nondiscrimination rules.

To illustrate what these rules do, consider the case of the employer, who has a tax-qualifying plan for three employees, the first employee, owner of a company, earns $200,000 in salary, and the other two earn $20,000 and $12,000, respectively.

If the owner sets up a plan at age 55, maintains it for 10 years, retires and dissolves the company, he can get an annual pension under the existing law of $136,425 each year, for the rest of his life. Under the integration rules and the other pension rules, this nondiscriminatory tax qualified plan will provide annual benefits of $1,890 and $975 to the other employees.

This is not equity, this is an outrageous abuse of the tax system and our taxpayers should not be asked to subsidize this plan.

This bill will permit integration but limited to the actual employers cost of providing an employee social security benefits.

This bill will put an end to the cases where social security benefits go up, and the employer gets the benefit instead of the employee. This bill would also provide more uniform nondiscrimination rules for other fringe benefits provided on a tax-free basis to employees.

The antiabuse rules are outrageously abused as people allegedly put large sums of money into retirement plans only to pull out these moneys for investment and charge interest rates which can be deducted for retirement plans that don't, in fact, exist.

We try, under this bill, to treat all professionals alike, and we know the testimony we are going to receive today certainly is going to be helpful to the full committee. There are many people that have testified or at least have stated in writing that the testimony will indicate that by reducing the tax-deferred benefits of a handful of pensioneers, less than 200,000, that somehow the rank-and-file of the people will suffer.

I do hope that the testimony will deal with specifics, because this member, and other members intend to make whatever adjustments are necessary to make sure the rank-and-file are not hurt.

We don't fully believe the testimony will suggest that the rank-and-file will be held hostage and threatened because of the more highly paid employees. I certainly believe that it is not going to be suggested that once we take care of the higher-paid executives that somehow this is going to trickle down to the rank-and-file.

There is a lot of discussion about integration and as this is being discussed, Mr. Chairman and members of the committee, I hope that you understand that under no system do we allow employers to take advantage of private pension plans or annuities that the employees have with other private employers.

It would seem to me to be inequitable to even suggest that the last employer would take advantage of all of the other plans that other taxpayers pay for the employee. Under existing law, this is done when the last employer takes advantage of all of the contributions that have been made by prior employers.

We do hope that we take advantage of what contribution they are making and that we can bring more equity to the system.

I want to thank the chairman and members of this committee for bringing this matter to a hearing, I do hope it will help for the concept of the substance of the change we find necessary.

Chairman ROSTENKOWSKI. Thank you, Mr. Rangel. Mr. Conable is recognized.

Mr. CONABLE. I don't want to prolong this further. I do believe the hearings are timely and I trust the witnesses will address the general principles involved here rather than seeming to preserve any particular advantage for any particular class of people.

The committee obviously has to be fair to the average wage-earner and develop a system which will encourage saving and stabilize and spread as broadly as possible the benefits of retirement income savings. I hope we will address that point rather than the issue of special privilege or of tax deferral generally.

In addition, I hope that the hearing will produce some simplification and rationalization of the ERISA legislation rather than further complication of it.

It is a tough balance to find. I suspect there is more to this issue than meets the eye, and I hope that we can find ways of dealing with it other than through further complicating a procedure which is already terribly complicated.

I think the hearing is timely and I trust we will have time to get into it on a sufficiently thoughtful and deep level, so that the net result will not be just some sort of a superficial adjustment, designed primarily for political reasons.

Mr. RANGEL. At the last meeting, I indicated that the mail I was receiving was heavy from the corporations in opposition to the bill. I do have a letter today from a lawyer in support of the legislation.

Chairman ROSTENKOWSKI. Welcome to the committee, Mr. Chapoton. The Chair would like to restate the intention to work through lunch today.

Welcome, Mr. Chapoton. It is a pleasure to have you with us. Please proceed with your testimony.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. I first want to apologize for my inability to appear as scheduled on June 8. As you know, this legislation is very far reaching, and I felt it was imperative that the Secretary of the Treasury be aware of the issues before our testimony was presented.

Because of his attendance at the Economic Summit, it was impossible for him to do so before our scheduled appearance on June 8.

The written statement I am presenting today is the statement that was prepared for presentation on Tuesday. For that reason, it still carries the date of June 8. The views that I express today are the views of the administration.

Our views of the tax policy aspects of H.R. 6410 are founded on four themes. First, our focus must be on strengthening and expanding the private pension system. Any proposed changes in the tax rules governing qualified plans which may have the effect of reducing benefits to rank-and-file employees must be very carefully scrutinized.

Second, in light of the President's creation of a bipartisan commission to develop proposals to restructure the Social Security system, we believe that it is premature to address the fundamental policy issues of the integration of social security with the private pension system.

Third, it is our view that the favorable tax provisions covering qualified plans are intended to stimulate savings to provide for an adequate level of retirement income. Thus, we are concerned to the extent that current law provides significant tax benefits which do not result in savings for retirement; which permit the accumulation of tax-favored savings beyond the level necessary to provide adequate retirement income; or which do not require employers to provide retirement income benefits for rank-and-file employees.

Finally, if our concerns with respect to current law are remedied, we believe that the rules governing qualified plans should not vary depending solely on the form in which the business is conducted or the nature of that business.

The issues raised by H.R. 6410 are complex, and many of them will require more comprehensive analysis than has been possible in the 20 days since the bill was introduced. However, we believe that H.R. 6410 contains a number of important proposals which, if refined, can greatly improve the tax treatment of tax-favored retirement plans.

As the members of the committee know, several general objectives underlie the tax rules applicable to qualified retirement plans. First, the provisions of the Internal Revenue Code granting favorable tax treatment to these plans are intended to encourage employers to provide retirement income to large numbers of working Americans. Thus, the code contains nondiscrimination rules designed to insure that the retirement plans that receive such favorable tax treatment distribute their benefits equitably among both highly compensated and rank-and-file employees. Other provisions of the code place limits on the amount of tax-favored benefits that may be made available to any one individual.

In spite of the code provisions designed to insure broad coverage and equitable distribution of benefits under qualified retirement plans, plans can still be designed so that almost all contributions to the plan inure ultimately to the benefit of the "prohibited group" of officers, shareholders, and highly compensated employees. The ability to obtain such a result indicates that our current methods of encouraging employers to provide retirement income to large numbers of employees have not been completely effective. In addition to this concern, there is a growing belief that the level of benefits which may be provided to one individual through these tax-favored plans is simply too high.

At the same time, many qualified plans, covering the overwhelming majority of participants, distribute benefits equitably across a broad spectrum of employees. It would be undesirable to impose unrealistic administrative burdens and unnecessary rigidity on plans that are serving their intended purposes. In addition, there is certainly no reason to have significantly different restrictions apply to qualified plans depending solely upon the legal entity used in conducting a business or upon the nature of the business being conducted.

With these background considerations in mind, I will now discuss the various changes proposed by H.R. 6410. My comments will be brief. My written statement contains a substantial amount of additional material that will further explain our position.

Section 2 of the bill deals with limitations on contribution and benefits under qualified plans. ERISA added section 415 to the code to impose limits on contributions and benefits under qualified plans. When established in 1974, these limits were $75,000 for defined benefit plans and $25,000 for defined contribution plans. The limits were indexed for increases in the cost of living, based on increases in the Consumer Price Index [CPI] and as a result, the 1982 limits are $136,425, for defined benefit plans, and $45,475 for defined contribution plans.

The bill would make five changes in these current limits on contribution and benefits. First, the dollar amounts would be decreased. The defined contribution limit would be decreased from the $45,475 level to $30,000 and the defined benefit level would be decreased from $136,425 to $90,000.

Second, the cost-of-living adjustments to the dollar limits would be eliminated.

Third, benefits to participants in multiple plans maintained by a single employer could not exceed those available under a single plan.

Fourth, actuarial reductions in the maximum dollar limits on pension benefits payable would be required if the individual retired before age 65.

Fifth, the dollar limits on maximum pension benefits would be reduced by the value of post-retirement medical benefits provided under a defined benefit plan.

Dealing first with dollar limitations on contributions and benefits, Treasury agrees that the limits on contributions and benefits contained in section 415 of the code should be reduced. Current dollar limits allow an overly generous amount of tax-favored retirement income. Our position on this issue is significantly influenced by the fact that the Economic Recovery Tax Act of 1981 expanded the opportunities for individuals to provide for retirement income by making deductible contributions to individual retirement accounts. ERTA also significantly reduced marginal tax rates, thus providing incentives for increased aftertax savings free of the investment restrictions applicable to qualified plan assets.

Reduction of these limits will make it easier to raise the level of deductible contributions to plans benefiting self-employed individuals. It will, therefore, facilitate the effort to achieve parity between corporate and noncorporate plans.

We recognize that reducing the dollar limits may decrease the incentive of certainly highly compensated individuals to establish qualified plans. We have also heard the argument that reducing the limits may cause some plan terminations. The committee should assess carefully the potential impact on rank-and-file employees in deciding upon the specific dollar limits to be set. We are not aware, however, of any empirical data indicating that reducing the dollar limits to the $30,000 and $90,000 levels proposed in H.R. 6410 will cause a significant number of existing plans to be terminated. If, indeed, the opportunity for high-income persons to set aside the larger amounts permitted by current law is all that keeps many rank-and-file employees covered by qualified plans, new approaches to tax incentives for retirement savings should be considered.

In considering cost-of-living adjustments, we believe that once realistic limits on allowable contributions and benefits are established, some method should be used to prevent their significant erosion in real dollar terms by inflation over a long period of time. While this can be accomplished by periodic congressional action if conditions warrant, many plan sponsors argue that problems of funding defined benefit plans make automatic annual adjustments preferable to adjustments at less frequent intervals. The extent of such funding problems should be investigated before the concept of automatic cost-of-living adjustments is rejected entirely.

If some means of automatic adjustment proves to be desirable, there appear to be several possible approaches that would be preferable to use of the Consumer Price Index alone. A wage-based index would appear to be an appropriate yardstick inasmuch as retirement income is a replacement for wages and therefore should not rise more rapidly than wages. Another alternative is indexing only for inflation in excess of a specified level.

Another possible method we should consider is to use whatever method is agreed upon by the Social Security Commission for indexing social security benefits.

A third issue is the limits available under multiple plans. The Treasury generally agrees with the principle that tax-favored retirement income should be limited to 100 percent of preretirement compensation. However, achieving this goal requires both complex transitional rules and complex plan amendments. Moreover, we understand that reducing the 1.4 limitation for combinations of defined contribution and defined benefit plans to 1.0 may affect many rank-and-file employees and may cause replacement of defined benefit plans with unfunded excess benefit plans. The latter development would be inconsistent with the goal of providing secure retirement income for employees. We believe, however, that methods can be developed that would prevent the change in the combined plan fraction from adversely affecting lower paid employees.

With respect to actuarial reduction of maximum benefits in the case of early retirement, we do support increasing beyond 55 the age at which maximum dollar pension benefits can be paid without actuarial reduction. This increase would eliminate one of the most significant abuses in the qualified plan area, that is, establishment of an artificially early retirement age in order to accelerate deductions for pension plan contributions. This change is also consistent with a retirement policy that recognizes longer participation in the work force by many Americans.

In addition, we suggest that consideration be given to amending section 415 to permit an actuarial increase in the maximum pension benefit payable to an individual who works beyond a given age, such as age 65. Such an increase probably has minimal effect on revenues and is also consistent with a retirement policy that encourages longer participation in the work force.

That concludes my remarks on section 2 of the bill. Section 3 deals with loans to key employees and would treat loans to key employees as taxable distributions from a plan.

Under current law, qualified plans generally may make loans to plan participants if the loans bear an adequate rate of interest, are adequately secured, provide a reasonable repayment schedule, and are available on a nondiscriminatory basis.

As a general matter, we do not believe that it is appropriate to permit plan loans except in carefully limited situations. Permitting loans from qualified plans conflicts with the primary purpose of these plans, which is providing funds for retirement incomes. Permitting such loans also creates a serious potential for abuse.

For example, the sole shareholder of a corporation may contribute and deduct the maximum plan contribution of $45,475, borrow the contribution out of his plan account, and then deduct the substantial interest payments, often in excess of 20 percent, that are paid to the plan and allocated to his account without regard to the section 415 limits on contributions and benefits. The shareholder may even recycle the original plan contribution, by annually borrowing from the plan the amount needed to make the succeeding year's contribution. Thus, the original contribution may be deducted many times over. Further, upon the shareholder's death, his taxable estate will be reduced by the amount of any unpaid loans. Although the discharge of the obligation to the plan produces income to the participant's estate or heirs, the estate benefits both from the reduction in the size of the estate and from the possible exclusion from the estate of the participant's interest in the plan.

Treasury believes that the proposal in H.R. 6410 to treat loans to key employees as distributions is a significant step in the right direction. However, we believe that the loan provision in H.R. 6410 may be overbroad in treating the 15 percent highest paid employees as key employees. As we understand the rationale of the provision, "key employees" generally are those who are deemed to have some control over deductions for plan contributions, and we question whether it is appropriate to assume that an individual will have such control simply because he or she is among the 15 percent highest paid employees.

Section 4 deals with the very complicated subject of integration with the social security system. One of the most complex and important issues raised by H.R. 6410 is the integration of plan contributions with benefits under the social security system.

As this committee knows, the President has created a bipartisan Social Security Commission to develop proposals to restructure the social security system. Treasury believes that it is premature to address the issue of defined benefit plan integration until the Commission's report has been issued and acted upon.

The Internal Revenue Code provides that a qualified plan which is properly integrated with the social security system may offer proportionately more generous benefits to higher paid employees covered by the plan. In effect, an employer is permitted to take all or part of its employer contributions to the social security system into account in determining whether its plan discriminates in favor of officers, shareholders, or other highly paid employees. The technical rules which must be satisfied by such a plan are contained in complex regulations and administrative interpretations published by the Internal Revenue Service.

H.R. 6410 would alter the integration rules applicable to both defined contribution and defined benefit plans. We understand that these changes are designed to remedy three shortcomings—perceived or real—in the current integration rules. First, H.R. 6410 is designed to simplify the integration rules. Second, it is designed to remedy the perceived inequity of the integration rules by requiring that all participants in defined benefit plans receive some benefits under the plan. Third, it is designed to allow each employer to integrate its plan only with respect to that employer's actual contribution under social security.

Under H.R. 6410, integration of defined benefit plans would be altered by reducing from 7 percent to 5.4 percent the amount of employer contributions that can be allocated solely to compensation in excess of the social security taxable wage base. This would be done by allowing employers to make plan contributions in an amount equal to the old age, survivors, and disability insurance [OASDI] component of the social security taxes multiplied by compensation in excess of the social security taxable wage base without providing any contributions attributable to compensation below that level.

The proposed change in H.R. 6410 in integration of defined contribution plans would treat employer contributions to social security in the same manner as contributions to a defined contribution plan. In contrast, the 7-percent figure now applied is not related to social security contributions. Instead, it is a rough approximation of the future benefits that would be provided by current employer-paid social security contributions. Thus, the 7-percent figure injects an inappropriate defined benefit element into defined contribution plans. Treasury believes this is clearly an anomaly and supports its elimination.

However, since the magnitude of the difference between employer OASDI contributions and the present 7-percent figure will decrease due to increases in the OASDI rate, the committee should consider carefully the cost implications of changing this integration rule at this time. Any change in the integration rule should also provide an adequate transition period in which plan amendments can be made.

Finally, revision of the defined benefit plan rules should be postponed until the Social Security Commission issues its report.

Sections 5 and 6 of the bill deal with plans for self-employed individuals and personal service corporations.

Under current law, plans that benefit self-employed individuals—H.R. 10 or Keogh plans—are subject to many restrictions not applicable to corporate plans. This lack of parity has existed for many years. Prior to 1962, qualified retirement plans could not be established for the benefit of self-employed individuals because they were not "employees." Beginning in 1962, self-employed individuals could participate in qualified retirement plans, but such plans were subjected to far more significant restrictions than those applied to other plans. These restrictions reflected a belief that self-employed individuals were unlikely to use tax-favored plans to benefit significant numbers of employees and would tend to use such plans for their own benefit.

The most obvious difference between H.R. 10 plans and corporate plans is that deductible employer contributions to an H.R. 10 defined contribution plan on behalf of a self-employed individual are limited to the lesser of $15,000 or 15 percent of earned income—not in excess of $200,000—whereas deductible contributions allocated to participant's account under a combination of corporate defined contribution plans can be the lesser of $45,475 or 25 percent of compensation. Except for this very significant restriction, H.R. 10 plans that do not benefit an individual with an interest in profits or capital of more than 10 percent—an "owner-employee"—are generally subject to the same rules as corporate plans.

In contrast, H.R. 10 plans that benefit an owner-employee are subject to a number of strict rules concerning participation, vesting, allowable nondeductible contributions, and the time at which distributions may be made.

H.R. 6410 would make three major changes in this area. First, the dollar limit on deductible contributions to H.R. 10 defined contribution plans would be increased to $30,000. Second, a number of restrictions now applicable only to owner-employee plans would be extended to all plans benefiting self-employed individuals. Finally, the rules applicable to plans benefiting self-employed individuals would be extended to plans maintained by certain personal service corporations.

We understand that these changes are designed to achieve parity between corporate and noncorporate plans. This is an important goal, which we support. However, we do not believe that these provisions of H.R. 6410 create parity. Instead, the bill would simply replace the existing distinction between corporate and noncorporate plans with a new distinction between the world of personal service and self-employed plans and the second, more favored, world of nonpersonal service corporate plans.

Rather than creating such distinctions, we believe that the H.R. 10 plan rules should be reexamined to determine which ones should be retained and applied to a wider universe of plans, and which should be eliminated altogether. We have examined the H.R. 10 plan rules, and I will very briefly outline our conclusions.

Provided that the section 415 limits are reduced to appropriate levels, we support increasing deductible contributions to H.R. 10 plans from $15,000 to $30,000. The need for retirement income is no different for a self-employed individual than for a corporate employee. We therefore believe that the increase in deductible contributions will eliminate an unjustifiable distinction that has existed far too long.

Moreover, if the dollar limit is to be increased, we see no reason to retain the 15 percent of earned income limitation for H.R. 10 plans. If parity in contributions is desired, this limit should be increased to 20 percent of earned income, which could be comparable to the 25 percent of compensation limit provided to the employee of a corporation.

Whether to retain the $200,000 limit on the earned income that may be taken into account in determining contributions and benefits under H.R. 10 plans poses a more difficult question. This limit can require an individual who wishes to maximize his or her retirement benefits to provide more substantial benefits to rank-and-file employees than would be required if the limit were abolished. For that reason we are reluctant to recommend removal of the $200,000 limit, and we think its effect should be carefully considered by the committee. If the $200,000 limit is appropriate, it should be extended to plans without regard to the nature or form of the business organization maintaining the plan.

We also believe that section 401(j), which prescribes rules for noncorporate defined benefit plans, should be deleted if the noncorporate deduction limits are increased. Section 401(j) was designed to insure that the benefits available under a noncorporate defined benefit plan would approximate those available had a defined contribution plan been established at the same time. If deductions for contributions to defined contribution plans are increased, section 401(j) would no longer be necessary. Section 401(j) is also complex and has hindered the establishment of defined benefit plans that cover self-employed individuals. Finally, section 401(j) does not effectively prevent manipulation of accrued benefits to favor the highly compensated. We therefore believe that section 401(j) should be eliminated.

We oppose the provision of H.R. 6410 that would extend the 3-year, 100-percent rule to all plans that benefit self-employed individuals. Extending the 3-year, 100-percent rule to all H.R. 10 plans would increase the costs of maintaining many plans that currently provide significant employee benefits and would limit flexibility in compensation planning. However, Treasury would not oppose imposing the 3-year, 100-percent rule or similar rules on all plans that provide disproportionate benefits to key employees. I will discuss this point in more detail later.

Plans that benefit owner-employees are also required to contain a definite formula for determining contributions to be made on behalf of participants. For reasons set forth in the statement, we question whether this rule should be required of any plan, and we oppose the extension of the requirement to plans that do not benefit owner-employees.

Turning to the treatment of personal service corporations, the provisions of H.R. 6410 that deal with plans that benefit the self-employed and plans maintained by personal service corporations are closely related. H.R. 6410 would eliminate the advantage obtained from incorporation by subjecting plans maintained by corporations engaged primarily in the performance of specified services to the rules applicable to noncorporate plans.

As we have indicated, the Treasury does not believe that the level of retirement benefits available to an individual should depend on whether his business is conducted in corporate form. Similarly, we do not believe that the level of retirement benefits, or the structure of a retirement plan, should depend on the trade or business in which an individual is engaged. We therefore oppose extending the restrictive rules now applicable to plans that benefit the self-employed to plans maintained by personal service corporations.

We recognize that parity between corporate and noncorporate plans cannot be achieved simply by increasing allowable deductions to noncorporate plans. Nor do we believe that all restrictions applicable to noncorporate plans should be eliminated.

Treasury believes that the following principles should be applied in seeking parity. First, if rules applicable to plans benefiting the self-employed promote retirement savings and hinder abuse of the tax qualification provisions, they should be applied to all plans.

Second, where rules applicable to plans that benefit the self-employed are restrictive, yet fail to encourage employers to provide benefits to a broad range of employees, these rules should be eliminated. Third, the participation and vesting rules applicable to plans that benefit owner-employees should only be applied to plans designed primarily to benefit members of the "prohibited group," that is, officers, shareholders, and the highly compensated, not to plans maintained by a specific type of entity or by an employer engaged in a specific trade or business.

Section 7 of the bill contains nondiscrimination rules for statutory fringe benefits. In recent years, the concept of nondiscrimination has been extended from qualified plans to many statutorily sanctioned fringe benefits. Self-insured medical plans, qualified group legal service plans, qualified transportation plans, educational assistance plans, and dependent care assistance programs are all subject to nondiscrimination rules. However, only the educational and dependent care assistance discrimination rules are identical. Each of the other discrimination tests is different, and none of the tests is the same as that applicable to qualified plans. Further, insured medical plans are not now subject to any nondiscrimination rules.

We welcome this effort to simplify the multitude of nondiscrimination rules. However, we have several comments concerning the operation of the proposed rules. Our basic reservation is that the proposed standards might introduce new and justified rigidity in the compensation planning process. We think that flexibility in designing a benefit package is desirable, and therefore we do not support imposing the uniform nondiscrimination rules at this time.

Finally, section 8 of the bill deals with the estate tax exclusion available for benefits under qualified plans. Under present law, benefits payable to the beneficiaries—other than the executor—of a deceased individual under a qualified plan or annuity or an individual retirement account generally are excludable from the decedent's gross estate for Federal estate tax purposes. H.R. 6410 would impose an aggregate limitation of $500,000 on the value of such benefits that may be excluded from a decedent's gross estate.

We support this provision of the bill. The Economic Recovery Tax Act of 1981 increased the unified credit against estate and gift taxes to expand the transfer tax exemption to $600,000 for individuals dying and gifts made after 1986. ERTA also enacted an unlimited marital deduction for transfers by an individual to his or her spouse. As a result, after 1986, the estate tax exclusion for qualified plans and similar arrangements will benefit only those individuals who have other assets exceeding $600,000 in value that pass to persons other than their spouses. We therefore do not think it inappropriate to impose a ceiling of $500,000 on the additional amount of property that such individuals can insulate from the estate tax by means of qualified plans and similar arrangements.

In conclusion, we know many practitioners are justifiably concerned about the time and money that must be spent in making plan amendments. We are committed to reducing the paperwork burden of establishing and maintaining qualified plans. Whatever plan amendments may be required as a result of legislation affecting the qualified plan area, we will attempt to make the amendment process as simple and streamlined as possible. However, the complexity and the cost caused by changes in the tax law should be a significant factor in this committee's deliberations on H.R. 6410.

That concludes the summary of my statement. I would be happy to answer any questions.

[The prepared statement follows:]

Statement of the Honorable John E. Chapoton, Assistant Secretary (Tax Policy), Department of the Treasury

Mr. Chairman and members of the committee, I am pleased to be here today to present the views of the Treasury Department on the tax policy aspects of H.R. 6410, the "Pension Equity Tax Act of 1982."

Our views of H.R. 6410 are founded upon four themes. First, any proposed changes in the tax rules governing qualified plans which may have the effect of reducing benefits to rank-and-file employees must be very carefully scrutinized. Indeed, our focus should be an strengthening and expanding the private pension system. Second, in light of the President's creation of a bipartisan commission to develop proposals to restructure the Social Security system, we believe that it is premature to address the fundamental policy issues of the integration of Social Security and the private pension system. Third, it is our view that the favorable tax provisions covering qualified plans are intended to stimulate savings to provide for an adequate level of retirement income. Thus, we are concerned to the extent that current law provides significant tax benefits which: (1) do not result in savings for retirement; (2) permit the accumulation of tax-favored savings beyond the level necessary to provide adequate retirement income; and (3) do not require employers to provide retirement income benefits for rank-and-file employees. Finally, if our concerns with respect to current law are remedied, we believe that the rules governing qualified plans should not vary depending solely on the form in which the business is conducted or the nature of that business.

The issues raised by H.R. 6410 are complex, and many of them require more comprehensive analysis than has been possible in the twenty days since the bill was introduced. However, we believe that H.R. 6410 contains a number of important proposals which, if refined, can greatly improve the tax treatment of tax-favored retirement plans.

BACKGROUND

The Internal Revenue Code now contains a number of provisions designed to promote retirement savings. These include provisions that permit the establishment of individual retirement accounts (IRA's), simplified employee pension (SEP's), and both corporate and noncorporate qualified retirement plans, including H.R. 10 or Keogh plans. In the case of qualified retirement plans, such contributions (which are part of employee compensation) are not taxable to employees until distributed, even though employers are allowed current deductions for plan contributions; plan earnings are exempt from tax when earned; participants enjoy favorable income tax treatment when distributions are received; and plan assets may be excluded from the participant's estates tax base.

Several general objectives underlie the tax rules applicable to qualified retirement plans. First, the provisions of the Internal Revenue Code granting favorable tax treatment to these plans are intended to encourage employers to provide retirement income to large numbers of working Americans. Thus, the Code contains nondiscrimination rules designed to ensure that the retirement plans that receive such favorable tax treatment distribute their benefits equitably among both highly compensated and rank-and-file employees. Other provisions of the Code place limits on the amount of tax-favored benefits that may be made available to any one individual. Finally, numerous provisions of the Code are designed to prevent various abuses of the special tax benefits provided for qualified plans.

In spite of the Code provisions designed to ensure broad coverage and equitable distribution of benefits under qualified retirement plans, plans can still be designed so that almost all contributions to the plan inure ultimately to the benefit of the "prohibited group" of officers, shareholders, and highly compensated employees. The ability to obtain such a result indicates that our current methods of encouraging employers to provide retirement income to large numbers of employees have not been completely effective. In addition to this concern, there is a growing belief that the level of benefits which may be provided to one individual through these tax-favored plans is simply too high.

At the same time, many qualified plans, covering the overwhelming majority of participants, distribute benefits equitably across a broad spectrum of employees. It would be undesirable to impose unrealistic administrative burdens and unnecessary rigidity on plans that are serving their intended purposes. However, to the extent that restrictions are needed to insure that the various policy objectives are achieved, such restrictions should apply uniformly to all types of plans except where special exceptions are clearly warranted. There is certainly no reason to have significantly different restrictions apply to qualified plans depending solely upon the legal entity used in conducting business or the nature of the business being conducted.

With these considerations in mind, I will now discuss the various changes proposed by H.R. 6410. A table setting forth the Treasury Department's estimates of the revenue effects of the bill is attached as an Appendix.

LIMITATIONS ON CONTRIBUTIONS TO AND BENEFITS UNDER QUALIFIED PLANS

Prior to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), the only limitations imposed by the Code on employer contributions to qualified plans were the limitations on current deductions for such contributions. Nondeductible employer contributions, which generate tax deferred earnings and subsequently receive favorable income and estate tax treatment, were limited only by the requirement, set forth in Rev. Rul. 72-3 1972-1 C.B. 105, that annual pension benefits could not exceed 100 percent of final pay. Employee contributions, which also generated tax deferred earnings, were limited only by the requirement that they be "reasonable" and that mandatory contributions not be so "burdensome" as to cause discrimination.

ERISA significantly changed this situation by adding section 415 to the Code to impose limits on contributions and benefits under qualified plans. These limits were intended both to place a ceiling on the retirement income that could be provided on a tax-favored basis and to constitute a step toward parity between self-employed and corporate plans. H.R. 6410 would strengthen these limits and promote parity by reducing the allowable contributions and benefits under qualified corporate plans and increasing the maximum deductible contributions to plans benefitting self-employed individuals.

Under section 415 of the Code, the annual additions[1] to a participant's account under a defined contribution plan cannot exceed the lesser of $45,475 or 25 percent of compensation.[2] Annual benefits under a defined benefit pension plan cannot exceed the lesser of $136,425 or 100 percent of compensation. Post-retirement medical benefits can be provided without reducing the dollar limit on benefits under a defined benefit plan. The dollar limits for both defined contribution and defined benefit plans are adjusted annually based upon increases in the consumer price index. When originally established in ERISA in 1974, the dollar limits were $25,000 and $75,000, respectively.

If both a defined contribution and a defined benefit plan are maintained, contributions and benefits of up to 1.4 times those allowable under a single plan are permitted. Thus, for example, the employer of an individual earning at least $136,425 in 1982 could make contributions on behalf of the individual to fund an annual pension benefit commencing at retirement of $136,425 (100 percent of the limit applicable to defined benefit plans) and could also contribute $18,190 (40 percent of $45,475) to the individual's account in a defined contribution plan.

The pension provided under a defined benefit plan can be calculated on the basis of a normal retirement age as low as 55. If the participant retires before age 55, the maximum dollar benefits must be reduced actuarially to reflect the longer period over which benefits will be paid. No actuarial adjustment providing benefits in excess of the maximum dollar limits under section 415 is permitted if the participant retires after age 55.

H.R. 6410 would make five changes in the current limits on contributions and benefits:

(1) the annual dollar limits would be decreased to $30,000 for defined contribution plans and $90,000 for defined benefit plans;

(2) Cost of living adjustments to the dollar limits would be eliminated;

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[1] Annual additions include employer contributions, forfeitures, and certain employee contributions allocated to the participant's account.

[2] Defined contribution plans include profit-sharing, stock bonus, and money purchase pension plans.

(3) Benefits to participants in multiple plans maintained by a single employer could not exceed those available under a single plan;

(4) Actuarial reductions in the maximum dollar limits on pension benefits payable would be required if the individual retire before age 65; and

(5) The dollar limits on maximum pension benefits would be reduced by the value of post-retirement medical benefits provided under a defined benefit plan.

1. Dollar limitations on contributions and benefits.—Treasury agrees that the limits on contributions and benefits contained in section 415 of the Code should be reduced. Current dollar limits allow an overly generous amount of tax-favored retirement income. Our position on this issue is significantly influenced by the fact that the Economic Recovery Tax Act of 1981 expanded the opportunities for individuals to provide the for retirement income by making deductible contributions to individual retirement accounts. ERTA also significantly reduced marginal tax rates, thus providing incentives for increased after-tax savings free of the investment restrictions applicable to qualified plan assets. Reduction of these limits will make it easier to raise the level of deductible contributions to plans benefitting self-employed individuals. It will therefore facilitate the effort to achieve parity between corporate and noncorporate plans.

We recognize that reducing the dollar limits on contributions and benefits may decrease the incentive of certain highly compensated individuals to establish qualified plans. We have also heard the argument that reducing the limits may cause some plan terminations. The commmittee should assess carefully the potential impact on rank-and-file employees in deciding upon the specific dollar limits to be set. We are not aware, however, of any empirical data indicating that reducing the dollar limits to the $30,000 and $90,000 levels proposed in H.R. 6410 will cause a significant number of existing plans to be terminated. If, indeed, the opportunity for high income persons to set aside the larger amounts permitted by current law is all that keeps many rank-and-file employees covered by qualified plans, new approaches to tax incentives for retirement savings should be considered.

2. Cost of living adjustments.—Once realistic limits on allowable contributions and benefits are established, some method should be used to prevent there significant erosion in real dollar terms by inflation over a long period of time. While this can be accomplished by periodic Congressional action if conditions warrant, many plan sponsors argue that problems of funding defined benefit plans make automatic annual adjustments preferable to adjustments at less frequent intervals. The extent of any such funding problems should be investigated before the concept of automatic cost of living adjustments is rejected entirely.

If some means of automatic adjustment proves to be desirable, there appear to be several possible approaches that would be preferable to use of the consumer price index alone. One approach is to base any increase on the change in a wage-based index if that would produce a smaller increase than using the consumer price index. A wage-based index would appear to be an appropriate yardstick inasmuch as retirement income is a replacement for wages and therefore should not rise more rapidly than wages. Another alternative is indexing only for inflation in excess of a specified level.

3. Limits under multiple plans.—Treasury generally agrees with the principle that tax-favored retirement income should be limited to 100 percent of pre-retirement compensation. However, achieving this goal requires both complex transitional rules and complex plan amendments. Moreover, we understand that reducing the 1.4 limitation for combinations of defined contribution and defined benefit plans to 1.0 may affect many rank-and-file employees and may cause replacement of defined benefit plans with unfunded excess benefit plans. The latter development would be inconsistent with the goal of providing secure retirement income for employees. We believe, however, that methods can be developed that would prevent the change in the combined plan fraction from adversely affecting lower paid employees. For example, the first $10,000 of pension benefits could be disregarded in computing the combined plan fraction under section 415(e), an approach similar to that now taken with regard to other section 415 limits. Alternatively, the combined plan fraction might be reduced only with respect to dollar limits, and not with respect to the percentage of compensation limits.

4. Actuarial reduction for early retirement.—Treasury supports increasing beyond 55 the age at which maximum dollar pension benefits can be paid without actuarial reduction. This increase would eliminate one of the most significant abuses in the qualified plan area, that is, establishment of an artificially early retirement age in order to accelerate deductions for pension plan contributions. This change also is consistent with a retirement policy that recognizes longer participation in the workforce by many Americans.

In addition, we suggest that consideration be given to amending section 415 to permit an actuarial increase in the maximum pension benefit payable to an individual who works past a given age, such as age 65. Such an increase probably has minimal effect on revenues and is consistent with a retirement policy that encourages longer participation in the workforce.

5. Reduction for post retirement medical coverage.—Treasury also supports the concept of reducing the maximum dollar limit applicable to pension plan benefits to take into account the annual value of post retirement medical coverage. We recognize that advance funding for such benefits is a fashionable device for significantly increasing current deductions for pension plan contributions, and we agree that such abuses should be stopped. However, we are not sure that there is a workable method under which the annual value of such benefits can be determined. We therefore cannot support the Committee's proposal in its present form. However, we would be happy to work with members of this Committee and its staff to explore alternative approaches to this problem.

LOANS TO KEY EMPLOYEES

Under current law, qualified plans generally may make loans to plan participants if the loans bear an adequate rate of interest, are adequately secured, provide a reasonable repayment schedule, and are available on a nondiscriminatory basis.

As a general matter, we do not believe that it is appropriate to permit plan loans except in carefully limited situations. Permitting loans from qualified plans conflicts with the primary purpose of these plans, which is providing funds for retirement income. Loans also permit participants to receive funds which are attributable to deferred compensation that has not yet been included in income. Permitting such loans creates a serious potential for abuse. For example, the sole shareholder of a corporation may contribute and deduct the maximum plan contribution of $45,475, borrow the contribution out of his plan account, and then deduct the substantial interest payments (often in excess of 20 percent) that are paid to the plan and allocated to his account without regard to the section 415 limits on contributions and benefits. The shareholder may even "recycle" the original plan contribution, by annually borrowing from the plan the amount needed to make the succeeding year's contribution. Thus, the original contribution may be deducted many times over. Further, upon the shareholder's death, his taxable estate will be reduced by the amount of any unpaid loans. Although the discharge of the obligation to the plan produces income to the participant's estate or heirs, the estate benefits both from the reduction in the size of the estate and from the possible exclusion from the estate of the participant's interest in the plan.

Enactment of the limitation on loans in H.R. 6410 would be a significant step toward eliminating these abuses. Pledges of individual retirement accounts have always been treated as causing a distribution of the entire account, and the Code has long required that loans to owner-employees and to shareholder-employees of Subchapter S corporations be treated as distributions. The Economic Recovery Tax Act of 1981 extended that rule to all self-employed individuals and applied the individual retirement account rule to loans of deductible employee contributions. H.R. 6410 would extend the rule by treating any loan to a "key employee" as a distribution. Individals subject to this restriction would include corporate officers, 5 percent shareholders, the 15 percent highest paid employees, beneficiaries of individual retirement accounts and section 403(b) annuities, and employees who elect deferrals under cash or deferred arrangements.

Treasury believes that the proposal in H.R. 6410 to treat loans to key employees as distributions is a significant step in the right direction. However, we believe that the loan provision in H.R. 6410 may be overbroad in treating the 15 percent highest paid employees as key employees. As we understand the rationale of the provision, "key employees" generally are those who are deemed to have some control over deductions for plan contributions. We question whether it is appropriate to assume that an individual will have such control simply because he is among the 15 percent highest paid employees. Where highly paid employees do have such control, they usually will be officers or 5 percent shareholders. The inclusion of the 15 percent highest paid employees as a separate category therefore appears unnecessary to achieving the purpose of the provision. Treatment of this group as key employees may also lead to difficulties in plan administration, for the 15 percent of employees who are most highly compensated must be determined both with respect to compensation in the calendar year preceding the loan and at the time of the loan. Eliminating the 15 percent highest paid employees from the category of key employees will avoid this complexity.

INTEGRATION WITH SOCIAL SECURITY

One of the most complex and important issues raised by H.R. 6410 is the integration of plan contributions with benefits under the Social Security system. As this Committee knows, the President has created a bipartisan Social Security Commission to develop proposals to restructure the Social Security system. Treasury believes that it is premature to address the issue of defined benefit plan integration until the Commission's report has been issued and acted upon.

The Internal Revenue Code provides that a qualified plan which is properly integrated with the Social Security system may offer proportionately more generous benefits to higher paid employees covered by the plan. In effect, an employer is permitted to take all or part of its employer contributions to the Social Security system into account in determining whether its plan discriminates in favor of officers, shareholders, or other highly paid employees. The technical rules which must be satisfied by such a plan are contained in complex regulations and administrative interpretations published by the Internal Revenue Service.

Integrated plans are categorized as either "excess" plans or "offset" plans. In an excess plan, the impact of Social Security is taken into account by providing proportionately larger benefits or contributions with respect to compensation above a certain level—referred to as the "integration level"—than with respect to compensation below that level. In an offset plan, the amount of benefits which would otherwise be provided by the plan is reduced (that is, offset) by a percentage of the primary insurance amount (PIA) received through Social Security.

One typical example of an excess plan is an integrated profit-sharing plan. Under the current rules, if the integration level is the Social Security taxable wage base, an employer may make contributions of as much as 7 percent of compensation above the integration leval without providing any contributions attributable to compensation below that level. Thus, for 1982, a profit-sharing plan may provide employer contributions of as much as 7 percent of compensation in excess of $32,400 without allocating any contributions to employees earning less than $32,400.

If the profit-sharing plan provides for contributions of more than 7 percent of pay in excess of the integration level, the additional amount must be provided to all employees in proportion to their compensation, including compensation below the integration level. For example, if the plan calls for contributions of 10 percent of compensation above the integration level, it must also provide contributions of 3 percent with respect to compensation below the integration level.

The "excess plan" integration method can also be used in defined benefit plans. The integration level for many of these plans is referred to as "covered compensation." Covered compensation for each year is the career average of the Social Security taxable wage base applicable to employees reaching retirement age in that year, averaged under the Social Security method. Thus, for any particular year, covered compensation is less than the current Social Security wage base because of increases in the wage base due to inflation. For an employee who reaches age 65 in 1982, covered compensation would be approximately $11,000.

Treasury regulations permit a pension plan to provide benefits in the form of a single life annuity with no ancillary benefits of as much as 37½ percent of the difference between an employee's actual average pay and his covered compensation without providing any benefits to an individual whose actual average pay is less than the covered compensation level. For example, an integrated plan covering an employee who retires in 1982 could provide benefits of up to 37½ percent of the employee's actual average pay in excess of $11,000 without providing any benefits for pay below that level. If the employee's actual average pay were below $11,000 no benefits would be required under the plan. If the plan provides benefits that are more than 37½ percent of the difference between actual average pay and covered compensation, some benefits must be provided with respect to actual average pay below the covered compensation level. For example, if a plan provides a benefit of 50 percent of actual average pay in excess of the covered compensation level, the plan must also provide benefits of 12½ percent of actual average pay below the covered compensation level.

The offset integration method can only be used by a defined benefit plan. The maximum permissible offset under a plan providing a single life annuity with no ancillary benefits is 83½ percent of the primary insurance amount (PIA) under Social Security. For example, an offset plan could provide a benefit of 50 percent of final average pay reduced by as much as 83½ percent of PIA. This means that, at low levels of compensation, the benefit nominally provided by the plan could be entirely offset by Social Security benefits.

H.R. 6410 would alter the integration rules applicable to both defined contribution and defined benefit plans. We understand that these changes are designed to remedy three shortcomings—perceived or real—in the current integration rules. First, H.R. 6410 is designed to simplify the integration rules. Second, it is designed to remedy the perceived inequity of the integration rules by requiring that all participants in defined benefit plans receive some benefits under the plan. Third, it is designed to allow each employer to integrate its plan only with respect to that employer's actual contribution under Social Security.

Under H.R. 6410, integration of defined contribution plans would be altered by reducing 7 percent to 5.4 percent the amount of employer contributions that can be allocated solely to compensation in excess of the Social Security taxable wage base. This would be done by allowing employers to make plan contributions in an amount equal to the Old Age Survivors and Disability Insurance (OASDI) component of the Social Security taxes multiplied by compensation in excess of the Social Security taxable wage base without providing any contributions attributable to compensation below that level. For 1982, the OASDI component of Social Security taxes is 5.4 percent and the Social Security taxable wage base is $32,400. Both figures will change when the OASDI tax or the Social Security taxable wage base change. The OASDI tax is currently scheduled to increase to 5.7 percent in 1985 and to 6.2 percent in 1990. The Social Security taxable wage base increases automatically as average wages increase.

The proposed change in H.R. 6410 in integration of defined contribution plans would treat employer contributions to Social Security in the same manner as contributions to a defined contribution plan. In contrast, the 7 percent figure now applied is not related to Social Security contributions. Instead, it is a rough approximation of the future benefits that would be provided by current employer-paid Social Security contributions. Thus, the 7 percent figure injects an inappropriate defined benefit element into defined contribution plans. Treasury believes this is clearly an anomaly and supports its elimination. However, since the magnitude of the difference between employer OASDI contributions and the present 7 percent figure will decrease due to increases in the OASDI rate, the Committee should consider carefully the cost implications of changing this integration rule at this time. Any change in the integration rule should also provide an adequate transition period in which plan amendments can be made.

The bill would make two changes in the integration rules applicable to defined benefit plans. The first change for defined benefit plans would permit plan benefits to be offset only by the value of the annuity attributable to the employer's OASDI contributions, accumulated with interest. This approach, which is similar to the proposed change in the defined contribution plan rule described above, would eliminate a problem that arises when a plan participant has worked for a number of employers. Each employer is able to include Social Security benefits attributable to prior employers in determining the allowable offset. The combined offset can easily exceed the permitted integration level for a single plan.

The second new integration rule proposed for defined benefit plans is an "excess" method intended to serve as a "safe harbor." Under this rule, known as "1-2-1," benefits based on compensation in excess of $60,000 can be no greater than benefits based in compensation below $30,000. Benefits based on compensation of $30,000 to $60,000 can be double those based on compensation above and below this range.

Both of the proposed new integration rules for defined benefit plans are conceptually more simple than the current integration rules. However, maintenance of different integration rules for pre-1984 and post-1983 participants in defined benefit plans would not be simple. A number of practitioners also have argued that the new defined benefit plan offset method would be difficult to apply in practice and might not achieve the desired results. Simpler methods of achieving the same goal may be possible. For example, the permitted offset could be limited to a participant's primary insurance amount (PIA) multiplied by a fraction, the numerator of which would be the participant's years of plan participation and the denominator of which would be the years taken into account in determining the participant's PIA.

Finally, as I have indicated previously, revision of the defined benefit plan integration rules should be postponed until the Social Security Commission has issued its report.

PLANS FOR SELF-EMPLOYED INDIVIDUALS AND PERSONAL SERVICE CORPORATIONS

Under current law, plans that benefit self-employed individuals (H.R. 10 or Keogh plans) are subject to many restrictions not applicable to corporate plans. This lack of parity has existed for many years. Prior to 1962, qualified retirement plans could not be established for the benefit of self-employed individuals because they were not "employees." Beginning in 1962, self- employed individuals could participate in qualified retirement plans, but such plans were subjected to far more significant restrictions than those applied to other plans. These restrictions reflected a belief that self-employed individuals were unlikely to use tax-favored plans to benefit significant numbers of employees and would tend to use such plans for their own benefit.

The most obvious difference between H.R. 10 plans and corporate plans is that deductible employer contributiuons to an H.R. 10 defined contribution plan on behalf of a self-employed individual are limited to the lesser of $15,000 or 15 percent of earned income (not in excess of $200,000) whereas deductible contributions allocated to a participant's account under a corporate defined contribution plan can be the lesser of $45,475 or 25 percent of compensation.[3]

Except for this significant restriction, H.R. 10 plans that do not benefit an individual with an interest in profits or capital of more than ten percent (an "owner-employee") generally are subject to the same rules as corporate plans. In contrast, H.R. 10 plans that benefit an owner-employee are subject to a number of strict rules concerning participation, vesting, allowable nondeductible contributions, and the time at which distributions may be made. These differences in treatment historically have been justified on the basis that sole proprietorships and small partnerships are more likely than large partnerships to design retirement plans solely as devices to benefit owners. Strict rules are viewed as necessary to prevent this result.

H.R. 6410 would make three major changes in this area. First, the dollar limit on deductible contributions to H.R. 10 defined contribution plans would be increased to $30,000. (The 15 percent of earned imcome limit would be retained, as would the rule that takes into account only the first $200,000 of compensation in determining permissible contributions and benefits.) Second, a number of restrictions now applicable only to owner-employee plans would be extended to all plans benefitting self-employed individuals. Finally, the rules applicable to plans benefitting self-employed individuals would be extended to plans maintained by certain personal service corporations.

We understand that these changes are designed to achieve parity between corporate and noncorporate plans. We believe that this is an important goal, which we support. However, we do not believe that these provisions of H.R. 6410 create parity. Instead, the bill simply replaces the existing distinction between corporate and noncorporate plans with a new distinction betweeen the world of personal service and self-employed plans and the second, more favored, world of nonpersonal service corporate plans. Rather than creating such distinctions, we believe that the H.R. 10 plan rules should be reexamined to determine which ones should be retained and applied to a wider universe of plans, and which should be eliminated altogether.

TREATMENT OF H.R. 10 PLANS

Provided that the section 415 limits are reduced to appropriate levels, we support increasing deductible contributions to H.R. 10 plans from $15,000 to $30,000. The need for retirement income is no different for a self-employed individual than for a corporate employee. Different deduction limits might be justifiable if corporations provided more substantial benefits to rank-and-file employees under their qualified plans than do partnerships and sole proprietorships. We are, however, not aware of any data indicating that corporate benefits per employee differ significantly from the benefits per employee provided by a partnership of the same size. We therefore believe that the increase in deductible contributions will eliminate an unjustifiable distinction that has existed far too long.

Moreover, if the dollar limit is to be increased, we see no reason to retain the 15 percent of earned income limitation for H.R. 10 plans. If parity in contributions is desired, this limit should be increased to 20 percent of earned income.[4]

Retention of the $200,000 limit on the earned income that may be taken into account in determining contributions and benefits under H.R. 10 plans poses a more difficult question. This limit can require an individual who wishes to maximize his or her retirement benefits to provide more substantial benefits to rank-and-file employees than would be required if the limit were abolished, For example, assume that a self-employed individual has earned income of $300,000. The maximum contribution of $30,000 would require a contribution rate of only 10 percent, whereas if only $200,000 of earned income could be taken into account, the required contribution rate would be 15 percent. Rank-and-file employees would receive significantly greater benefits in the latter case. We therefore are reluctant to recommend removal of the $200,000 limit on the earned income taken into account in determining contributions and benefits. Since imposing this limit only on self-employed plans would retain an incentive for incorporation, consideration should be given to extending a similar limit to all plans.

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[3] Deductible contributions to both corporate and noncorporate plans are, of course, also subject to the limits on deductions contained in section 404 of the Code.

[4] Since earned income is calculated prior to deductions for plan contributions, while corporate compensation does not include plan contributions, a contribution of 20 percent of earned income is the equivalent of a contribution of 25 percent of compensation.

We also believe that section 401(j), which prescribes rules for noncorporate defined benefit plan should be deleted if the noncorporate deduction limits are increased. Section 401(j) was designed to ensure that the benefits available under a noncorporate defined benefit plans would approximate those available had a defined contribution plan been established at the same time. If deductions for contributions to defined contribution plans are increased, section 401(j) would no longer be necessary. Section 401(j) is also complex and has hindered the establishment of defined benefit plans that cover self-employed individuals. Finally, section 401(j) does not effectively prevent manipulation of accured benefits to favor the highly compensated. We therefore believe that section 401(j) should be eliminated.

Next I will turn to the owner-employee plan rules that the bill would apply to all plans benefitting self-employed individuals. Treasury believes that some of these rules should be applied to all qualified plans, while others should be eliminated.

Under current law, plans that benefit owner-employees must cover all employees who have completed three or more years of service, except for members of certain collective bargaining units. All participants must be 100 percent vested in their accured benefits. In contrast, plans that benefit self-employed individuals who are not owner-employees need merely cover one of the following groups: 1) 70 percent of all employees; 2) 80 percent of the employees eligible to benefit under the plan if at least 70 percent of employees are eligible to participate; or 3) a nondiscriminatory classification of employees. In each case, employees who have not fulfilled the plan's minimum age or service requirements can be excluded, as can members of certain collective bargaining units. In addition, plans that do not benefit an owner-employee may use any of the normal vesting schedules found in section 411(a)(2) of the Code. As an example, provided that discrimination does not result, such a plan may use ten year "cliff" vesting. Under this schedule, a participant has no vested plan interest until he or she has completed 10 years of service. At that time, his or her interest in the plan becomes 100 percent vested.

We oppose the provision of H.R. 6410 that would extend the three year/100 percent rule to all plans that benefit self-employed individuals. Extending the three year/100 percent rule to all H.R. 10 plans would increase the costs of maintaining many plans that currently provide significant employee benefits and would limit flexibility in compensation planning. However, Treasury would not oppose imposing the three/100 percent rule or similar rules on all plans that provide disproportionate benefits to key employees. I will discuss this point in more detail later.

Plans that benefit owner-employees are also required to contain a definite formula for determining contributions to be made on behalf of participants. For example, contributions might be 1 percent of profits in excess of $100,000. H.R. 6410 would extend this requirement to all noncorporate plans, presumably to prevent manipulation of plan contributions by owners. However, given the flexibility that can be incorporated into an acceptable contribution formula, plus the ability to amend the plan's contribution formula, we doubt that this requirement places significant constraints on plan sponsors. Indeed, if the requirement did operate effectively, it could prevent proprietorships and small partnerships from devoting sufficient profits to capital needs. It might also prevent their use of cash or deferred arrangements, although this issue is undecided. We therefore question whether a definite contribution formula should be required for any plan. We oppose extension of the requirement to plans that do not benefit owner-employees.

Current law also restricts the nondeductible contributions that may be made on behalf of an owner-employee. Nondeductible employer contributions may not be made on behalf of an owner-employee, and nondeductible employee contributions may not be made by an owner-employee who is the sole participant in a plan. Both restrictions limit the ability of owner-employees to use qualified plans to generate tax-deferred income. H.R. 6410 would apply both rules to all plans that benefit self-employed individuals.

Although this aspect of the bill requires further study, we question whether these two restrictions are needed in H.R. 10 plans that do not benefit owner-employees. On the other hand, we believe that it may be desirable to extend the restriction on nondeductible employer and employee contributions to corporate plans that benefit only a sole shareholder. For example, under current law, a sole shareholder who is the participant in a corporate profit-sharing plan can benefit from a deductible employer contribution of 15 percent of compensation, a nondeductible employer contribution of 10 percent of compensation, a nondeductible employee contribution of 6 percent of compensation, and a deductible employee contribution of up to $2,000 without exceeding the requirement that annual additions cannot exceed 25 percent of compensation. As a result, notwithstanding the limits of section 415, up to 31 percent of compensation, plus $2,000 can be placed in a tax-exempt trust under a qualified corporate plan that benefits only a sole shareholder. This level of contributions to a tax-exempt trust erodes the income tax base, and cannot be justified on the basis of providing retirement income to broad groups of employees where a shareholder is the sole plan participant.

Under current law, distributions to owner-employees are subject to special restrictions. A 10 percent penalty is imposed on distributions to an owner-employee who has not attained age 59½ or become disabled, and contributions cannot be made on behalf of the owner-employee during the five years following such a distribution unless the distribution resulted from a plan termination. The restrictions on owner-employee distributions help ensure that qualified plans are used to provide retirement income, rather than as tax-sheltered saving accounts. H.R. 6410 would extend these penalty provisions to distributions from an H.R. 10 plan to any self-employed indivual.

Treasury believes that premature distributions detract from the role of qualified plans as vehicles to provide retirement income. We therefore believe that there may be merit in extending restrictions of the type proposed by H.R. 6410 to premature distributions to key employees who participate in either corporate or noncorporate plans.

Finally, present law requires that an owner-employee's entire interest in the plan be distributed within five years of the death of the owner-employee and his or her spouse. The bill would extend this requirement to benefits for self-employed individuals under all H.R. 10 plans. This provision limits the ability to maintain tax deferral after the retirement income needs of the self-employed individual and his spouse have ceased. Treasury therefore supports this provision of the bill. Indeed, we believe that the post mortem distribution requirement should be made applicable to benefits for all participants in all qualified plans.

TREATMENT OF PERSONAL SERVICE CORPORATION PLANS

The provisions of H.R. 6410 dealing with plans that benefit the self-employed and plans maintained by personal service corporations are closely related. During recent decades, a substantial number of professionals have incorporated in order to escape the limitations on deductions and the restrictive rules applicable to self-employed plans. H.R. 6410 would eliminate the advantage obtained from incorporation by subjecting plans maintained by corporations engaged primarily in the performance of specified services (health, law, accounting, actuarial science, architecture, engineering, consulting, performing arts and athletics) to the rules applicable to noncorporate plans.

As indicated above, Treasury does not believe that the level of retirement benefits available to an individual should depend on whether his business is conducted in corporate form. Similarly, we do not believe that the level of retirement benefits, or the structure of a retirement plan, should depend on the trade or business in which an individual is engaged.[5] We therefore oppose extending the restrictive rules now applicable to plans that benefit the self-employed to plans maintained by personal service corporations.

Treasury recognizes that professional corporations exist largely due to the more liberal rules applicable to their qualified plans. Treasury also recognizes that there is widespread belief that professionals are more likely than other individuals to use qualified plans as tax shelters rather than as employee benefit plans. However, practices that result in benefits being provided primarily to owners are by no means limited to plans maintained by personal service corporations. Other corporations may also structure their qualified retirement plans to provide benefits primarily to owners. Thus, extending the H.R. 10 rules to personal service corporations will not eradicate the practice of designing plans under which most benefits flow to owners and to the highly compensated.

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[5] Such distinctions are inevitably arbitrary. H.R. 6410 does not, for example, treat incorporated insurance or real estate agents in the same manner as incorporated actuaries.

At the other end of the spectrum, some personal service corporations, like partnerships, employ substantial numbers of employees. Plans maintained by such large personal service corporations typically resemble the plans maintained by other large corporate employers. i.e., they are designed as part of an employee compensation package, not as a tax shelter. As a result, extending rules applicable to self-employed plans to the plans of personal service corporations would place unnecessary restrictions on a number of plans maintained by personal service corporations.

We recognize that parity between corporate and noncorporate plans cannot be achieved simply by increasing allowable deductions to noncorporate plans. Nor do we believe that all restrictions applicable to noncorporate plans should be eliminated. Treasury believes that the following principles should be applied in seeking parity. First, if rules applicable to plans benefiting the self-employed promote retirement savings and hinder abuse of the tax qualification provisions, they should be applied to all plans. Requiring that distributions commence at age 70½ limits use of qualified plans to escape income tax, while requiring distributions within five years of the death of a participant or his or her spouse prevents unwarranted extension of periods of tax-deferred earning. Both these requirements should be applied to all qualified plans and similar arrangements, such as section 403(b) annuities and individual retirement accounts. Similarly, the treatment of loans to the self-employed should be expanded to loans to all key employees.

Second, where rules applicable to plans that benefit the self-employed are restrictive, yet fail to encourage employers to provide benefits to a broad range of employees, these rules should be eliminated. As I have indicated previously, the defined benefit plan rules contained in section 401(j) fall into this category, as does the requirement of a definite contribution formula for owner-employee plans.

Third, the participation and vesting rules applicable to plans that benefit owner-employees should only be applied to plans designed primarily to benefit members of the "prohibited group," i.e., officers, shareholders (or other owners) and the highly compensated, not to plans maintained by a specific type of entity or by an employer engaged in a specified trade or business. Unfortunately, at the present time, we have no data that indicates what type of employer is most likely to establish a retirement plan primarily for the benefit of the prohibited group. Therefore, if this Committee believes that the application of the three year/100 percent or similar rules relating to participation and vesting should be extended, we suggest that they be extended not to entities or to professions but to all plans that benefit the prohibited group. The "key employee" concept might be used for this purpose. For example, a more restrictive rule could be applied to "key employee plans," which could be defined as plans in which key employees have vested accrued benefits with a present value equal to 50 percent or more of the present value of the vested accrued benefits under the plan. We would be happy to work with the members of this Committee and its staff to explore this alternative.

UNIFORM NONDISCRIMINATION RULES FOR STATUTORY FRINGE BENEFITS

In recent years, the concept of nondiscrimination has been extended from qualified plans to many statutorily sanctioned fringe benefits. Self-insured medical plans, qualified group legal service plans, qualified transportation plans, educational assistance plans, and dependent care assistance programs are all subject to nondiscrimination rules. However, only the educational and dependent care assistance discrimination rules are identical. Each of the other discrimination tests is different, and none of the tests is the same as that applicable to qualified plans. Further, insure medical plans are not now subject to any nondiscrimination rules.

H.R. 6410 would apply uniform nondiscrimination rules to all of the preceding statutory fringe benefits. Both coverage and benefits would be required to meet nondiscrimination tests. A plan providing any of the enumerated benefits would first be required to benefit one of the following three categories of employees: 1) 70 percent or more of all employees; 2) a group in which no more than 15 percent of participants are key employees; or 3) a nondiscriminatory classification of employees. In addition, plan benefits would generally be discriminatory unless plan benefits equal to those available to key employees were also available to all participants. Pay-related benefits would be allowed only in the case of group term life insurance. If either the coverage test or the benefit test were not met, the benefits provided to key employees would be includible in their gross income.

We welcome this effort to simplify the multitude of nondiscrimination rules. However, we have several comments concerning the operation of the rules contained in this bill.

Our first concern is that H.R. 6410 fails to define what constitutes equal benefits. For example, under an educational assistance program, does equality of benefits depend on the number of credits for which tuition expenses will be reimbursed or does it require that an equal dollar amount be available to each participant? We believe that clear and enforceable definitions of equality are imperative if an equal benefit standard is to be applied.

The equal benefit standard of H.R. 6410 also fails to recognize that different medical, legal, or other plans may be appropriate in different regions or in different types of business activity. For example, medical benefits available to employees working in a Western mining subsidiary of a large corporation may differ substantially from those available to employees of an Eastern service subsidiary. The bill provides no guide for determining the comparability of those benefits, nor does it permit equality of benefits to be tested on the basis of employees who are similarly situated in terms of location, marital status, and other factors.

The equal benefits test may also harm employers who attempt to contain health care costs by offering optional lower cost medical plans to their employees. An approach similar to that taken in section 125(g)(2) of the Code, relating to health benefits under cafeteria plans, might avoid this problem.

With respect to the statutory fringe benefits that would be subjected to the nondiscrimination rules, we are concerned about the application of nondiscrimination rules to insured medical plans. In general, cost savings resulting from including a large number of individuals in the insured plan militate against discrimination. In addition, the deductibility by individuals of medical expenses in excess of a floor amount limits the value of this fringe benefit. Absent evidence that these plans operate in a discriminatory manner, we question subjecting these plans to the administrative burdens of compliance with nondiscrimination rules. At a minimum, since disability benefits provided under medical plans are designed to enable a participant to maintain an existing standard of living, any discrimination test applicable to disability benefits should be pay-related.

The application of nondiscrimination rules, albeit pay-related, to group term life insurance poses additional questions. While we understand that underwriting considerations favor coverage of substantial numbers of employees, Treasury is concerned with the use of retired lives reserves and with certain cases in which "jumbo" policies are provided to key employees. Although the value of such coverage in excess of $50,000 is includible in gross income, this value is determined by tables that may not reflect the cost of the coverage provided. In view of the special factors applicable to life insurance benefits, we believe that further study is required to determine what, if any, nondiscrimination rules should be applied to this form of benefit.

Our final reservation concerning uniform nondiscrimination standards is that the proposed standards may introduce new and unjustified rigidity into the compensation planning process. We are specifically concerned that the provisions of H.R. 6410 may prevent employers from offering their employees a choice among statutory fringe benefits. In recent years, a growing number of employers have sought to hire and retain productive employees by offering flexible benefit packages that meet diverse needs. We believe that this is a positive development, and we are concerned that the "equal benefit" standard of H.R. 6410 may deter the development of such innovative approaches to compensation planning.

Due to the problems I have outlined, Treasury does not support the uniform nondiscrimination rules contained in H.R. 6410. However, we would be happy to work with members of the Committee and its staff to refine the nondiscrimination rules for statutory fringe benefits contained in H.R. 6410. We believe that this can be an extremely valuable step toward simplification of the Internal Revenue Code.

ESTATE TAX EXCLUSION

Under present law, benefits payable to beneficiaries (other than the executor) of a deceased individual under a qualified plan or annuity of an individual retirement account generally are excluded from the decedent's gross estate for Federal estate tax purposes, provided the beneficiaries forego the special 10-year averaging and long term capital gain income tax treatment otherwise applicable to certain lump sum distributions. A similar estate tax exclusion is provided for amounts payable under Federal law to survivors of retired servicemen. H.R. 6410 would impose an aggregate limitation of $500,000 on the value of such benefits that may be excluded from a decedent's gross estate.

Treasury strongly supports this provision of the bill. The Economic Recovery Tax Act increased the unified credit against estate and gift taxes to expand the transfer tax exemption from $175,625 to $600,000 for individuals dying and gifts made after 1986. ERTA also enacted an unlimited marital deduction for transfers by an individual to his or her spouse. As a result, after 1986, the estate tax exclusion for qualified plans and similar arrangements will benefit only those individuals who have other assets exceeding $600,000 in value that pass to persons other than their spouses. We do not think it inappropriate to impose a ceiling of $500,000 on the additional amount of property that such individuals can insulate from the estate tax by means of qualified plans and similar arrangements.

Indeed, Treasury seriously questions whether there is a valid reason for providing any estate tax exclusion for such benefits. This position is based on our general view that particular classes of property should not be singled out for preferential treatment under the estate tax law.

We also have one technical comment on the estate tax provision of the bill. If the estate tax exclusion for qualified plans, etc., under section 2039 of the Code is amended, conforming changes may be needed in section 2517, the gift tax exclusion for lifetime transfers of such benefits. This technical issue is one that requires further study.

I would be pleased to answer any questions you may have.

The effect on receipts of H.R. 6410

	Billions of dollars
1983	0.1
1984	0.6
1985	1.0
1986	1.2
1987	1.4

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, June 7, 1982.

Chairman ROSTENKOWSKI. Mr. Chapoton, on page A-15 of your prepared statement, you state that you support the proposed rule for parity between corporate and noncorporate plans. You made a number of constructive comments in this area with respect to the Rangel bill.

I am personally supportive of the efforts to achieve parity in this area of the pension tax law. I hope that we can work together on this important issue. Therefore, I accept your offer to sit down with our staff to work out some accommodation with respect to the corporate/noncorporate parity issue.

As I am sure that you are aware, this is a very difficult area. However, we have a rare opportunity to achieve parity and simplification. I think that working together we can do this. So I look forward to having the Treasury Department and our staff work together on this parity issue.

Mr. CHAPOTON. We welcome that. We would like to work together on that point.

Chairman ROSTENKOWSKI. Mr. Pickle will inquire.

Mr. PICKLE. I thank you for your testimony. We are glad to have it presented in such a forthright manner.

First, do you agree that the contribution limit should be reduced, as in H.R. 6410, from $45,000 down to $30,000? Are you agreeable to the $30,000 level?

Mr. CHAPOTON. Mr. Pickle, we agree that some reduction in the limits ought to be made, but we are not prepared to say $30,000 is the right level. Indeed that might be too great a reduction. In addition we must take into account what is done with indexing. If indexing is eliminated, you have to be more careful on how far the ceiling is reduced.

Mr. PICKLE. Can you give me an estimate, assuming there is a general agreement on the reform, of the amount of revenue that would be involved? What would be the savings we could reach a general agreement here?

Mr. CHAPOTON. On dropping the limit alone or on the whole bill?

Mr. PICKLE. The whole bill, the revenue effect if we made these changes?

Mr. CHAPOTON. The revenue effect would be $19 million in fiscal 1983, $422 million in fiscal 1984, and $979 million in fiscal 1985.

Mr. PICKLE. It would not be much the first year.

Now with respect to social security, there is some reason to delay considering the fact that the National Commission will be looking at this problem; we all seem to want to crawl under that umbrella for that protection and a little delay and a little insurance.

It ought to be understood basically that in intergrating pension plans with social security we do not really directly add any more money to the social security trust funds nor do we take any out of the trust funds.

You made a statement that you thought we should delay this. Let me ask you a question for my general information: According to the bill that is before us, or any combination of it, integration with the social security system would be based solely on the value of the social security tax, that is the OASI and the DI tax, paid by the employer and not on the basis of social security benefits.

Now, if we wait then for the Commission to act, and then we accomplish action in the form of a benefit structure, that would have no impact on the integration rules. Further, any social security tax increases would only seem to increase the amount of integration and therefore could easily be accommodated.

Your premise is that we are making this integration on the basis of the value rather than of the benefits. I ask you the question, do we really gain anything by doing that?

Mr. CHAPOTON. I see your point, Mr. Pickle. I think I would make two comments. One, I think we can all agree that the integration rules are extremely complex and that their impact is extremely far-reaching. As I stated in my written statement, there are a number of problems one might point to in the present integration rules. These rules might have results that you would not want if you were redesigning the system. However, once the system is in place, you must be extremely careful in changing the integration rules with respect to the broad range of employees covered by plans, because you are affecting a large number of plans.

Mr. PICKLE. Suppose that we did delay the integration but go ahead now to enact legislation and setting new limits on the pension plan deductions this year, and then wait for next year for the integration rules, would that not mean that the plan would have to be amended twice?

Mr. CHAPOTON. That is correct.

Mr. PICKLE. Would it not be better if we proceeded now?

Mr. CHAPOTON. That would be an argument on the other side. But, Mr. Pickle, I think we have to be very careful. I want to stress how complex and far reaching those rules are. I think we ought to see what is done to the social security system. While I think your point that changes in the social security system may not have any significant impact on the integration rules is well made, it is my view that we should go slow here.

Mr. PICKLE. What you are saying is that you in effect agree that there are problems in that area and you want to go slow.

Mr. CHAPOTON. That is correct.

Mr. PICKLE. I thank you, Mr. Chairman.

Mr. RUSSO [presiding]. Mr. Chapoton, the committee will be in recess for 5 minutes.

[Recess.]

Mr. RANGEL. I want to thank the Secretary for his contribution this morning. And it appears to me regarding most of the issues that you were in total agreement with the concept that the technicalities could be worked out.

There is a serious legislative question about the treatment of different entities when actually we are concerned with the tax provision as it relates to the investor. There is a serious question about the distinction between corporations that provide personal services. No one can argue on the question of transition.

When it involves integration, we are dealing with a political question rather than a legislative question. I do not see where the Social Security Commission can take away the fact that certain employers make a contribution. This is what this legislation attempts to deal with. That is, if you have one, two, three, four, employers, and the fourth employer be credited with the contribution made by employer one, two, three, it would seem to me, notwithstanding the political questions that we have to resolve, that the Social Security Commission should not believe that the Ways and Means Committee does not have jurisdiction over the question.

I am asking, do you have any problem with employers only being able to take advantage of the contribution that they made to that particular employee's social security system?

Mr. CHAPOTON. When you ask the question directly like that it is hard to say anything, but that there is a problem with that rule. But I want to qualify my answer by adding that these rules are so involved and their impact is so great, that the existing problems with integration rules lead to the conclusion that these rules should not be changed immediately. I would personally need to review those rules more and be more comfortable with the effect of changes than I am today.

On the question of the Social Security Commission, it will be important to know what social security benefits will be in order to change the integration rules. That is not a political question. I think it is a very real problem for employers.

Mr. RANGEL. Well, I can appreciate the fact that it is complex enough that the administration wanted to take more time to look at it. But if you can agree with the objectives of this legislation as you have in your testimony, you may find some people testifying that if we enact this legislation, that some of their clients may cheat and not pay any taxes.

I do not think they will be prepared to say that.

If what we are saying is that there has to be a limit to the amount of money that taxpayers pay for higher paid executives to shelter their income, and if we agree that some shelter is good because it is an independent private pension plan then all we are saying is that the rank and file should be able to participate.

If you know as a fact the formulas that we are using and you have testified to, are not realistic, that the 7 percent used should be a lower figure, if you know that is wrong, why do we have to wait for a commission that has no legislative responsibility to deal with it. I am not saying that the administration should agree with everything that is in the bill. However, I do not see how we can say with the inequities that exist, that the Congress and the administration should not have the courage to make some recommendations to the citizen's committee that the President set up.

Is that asking too much?

Mr. CHAPOTON. No. It is not asking too much. I would simply stress two points in the testimony. First, the level of social security benefits is being addressed by a bipartisan commission. Second, I want to emphasize how significant the integration rules are to the private pension system in this country. I therefore think we should go slowly and wait until we see what the Social Security Commission recommends, and what the Congress does in response to those recommendations before we change the integration rules.

I would add that the problem you mention with using 7 percent rather than 5.4 percent was much worse a few years ago when the 5.4 percent was at the 3.5-percent level. There was much greater disparity. The problems have been around a long time, and they probably are decreasing with the passage of time. I think we need to take a very long look at the proposed changes.

Mr. RANGEL. I am certain that the administration has statistical data to show that these packages are put together in order to either have the minimum cost for the employers or maximum tax free benefits for the beneficiaries. If you are convinced because of the integration formulas that are used, that the rank-and-file are not receiving anything near any equity in this, are you still suggesting that this committee should wait to see what recommendation the President's Commission on Social Security makes before we try to work out an agreement between the administration and the Congress?

Mr. CHAPOTON. I am not ready to agree that the integration rules work that way. I think they need to be studied to see if they do work that way. I think it is certainly appropriate for this committee to study in depth the effect of the rules and perhaps have changes ready to go in place when we see what changes the Social Security Commission recommends.

Mr. RANGEL. I offered a hypothetical. The hypothetical was that, it could be proved to your satisfaction that the rank and file are not receiving the benefits of these tax shelters. Do you believe that the administration and the Congress should work together prior to or should wait for what recommendations come out of the Social Security Commission?

Chairman ROSTENKOWSKI. The gentleman's time is expired.

Mr. Fowler will inquire.

Mr. CHAPOTON. That is not what I am saying.

Mr. FOWLER. I yield my time.

Mr. RANGEL. I think the administration has been candid. There may be a lot of things to be studied. I do not want you to say to this committee that if we can prove to you that the inequities exist and if you can see that rank-and-file have no input in these decisions, your staff will listen to the witnesses that put together the packages.

We have information that shows employers talk to the individual, how much do you want to make? How much are you willing to pay? You know it; I know it. I do not mind running to the Commission on the question of COLA's and social security until after the election. But for the people affected today, we do not have to run behind the Commission on this question.

You have said that we have to reform and if you need more information to show the inequities that exist, as it relates to the integration system, I have no problem with it. I am only asking that if you are convinced, as I am certain you will be, would you then still suggest that on the question of integration, employer contribution percentage, that we wait until after the election? Because you are putting me out of business.

Mr. CHAPOTON. I suppose then my primary consideration would be to try to be as certain as the Treasury and this committee can be, that any change, even if it corrects what you consider an abuse, does not dramatically reduce coverage of the private pension system.

That must be our concern. I know it is your concern, and that is our concern.

Mr. RANGEL. I join with you in that concern. I do not believe that every time the Congress has a difficult decision to make in a controversial area, that a commission will be appointed. I was prepared to listen to a lot of opposition to the bill which I did not get. But I never thought that the question of pension funds and abuse of the system as relates to the rank-and-file would be referred to the President's Commission on Social Security.

I would like to refer the budget decision today to the Commission, too. But we just cannot—we cannot do it every time we are at bat. I do hope that I can continue to enjoy the cooperation with your staff and the committee staff to see whether we could reach some conclusion prior to that time, if the Commission ever deals with this. I want to thank you for your testimony.

Chairman ROSTENKOWSKI. Mr. Duncan will inquire.

Mr. DUNCAN. I have no questions.

Chairman ROSTENKOWSKI. Did you have questions, Mr. Fowler?

Mr. FOWLER. I have just one.

On a not unrelated matter, since today is budget day, we received approximately $10.5 million in revenue raises from the administration, and on any and all of the budgets proposed, we hope something passes. There is a minimum of $20 million. It is certainly included in the Latta budget.

When can we expect your recommendation for an additional $10 billion to $12 billion in revenue raises on top of those you have already given?

Mr. CHAPOTON. Mr. Fowler, I cannot answer that. We are working with the staff of this committee and the staff on the Senate side to try to see what would be appropriate to fill that additional gap. It is very difficult to do.

I simply cannot give you a date of when we might send specific proposals forward.

Mr. Fowler. You agree that is a baseline figure?

Mr. Chapoton. It appears the $20 million figure for 1983 is developing as a baseline figure.

Mr. Fowler. I have no further questions.

Thank you, Mr. Chairman.

Chairman Rostenkowski. Mr. Vander Jagt will inquire.

Mr. Vander Jagt. I have no questions.

Chairman Rostenkowski. Mr. Moore will inquire.

Mr. Moore. Thank you, Mr. Chairman.

Mr. Secretary, in particular on section 2 of the bill, points 1, 2, and 3 on pages 5, 6, and 7 of your testimony, deal—correction, points 2, 3 and 4 deal with such things as the cost-of-living adjustment, limits under multiple plans, no more than a 100 percent of preretirement compensation and the early retirement at age 55 problem.

Do you subscribe to making these same limitations applicable to all retirement plans—Government, social security, whatever?

Mr. Chapoton. That question is not applicable, if you are dealing with only the limits, because Government retirement benefits do not reach those limits. Certainly, if you talk about changes in indexing, it seems to me it would be appropriate across the board. But the other limits, the dollar limits, would not be applicable.

Mr. Moore. Well, you have early retirement at age 55. We do have Members of Congress retired now receiving more money than we currently receive as active Members of Congress.

Mr. Chapoton. That is correct. It would seem to me logic would insist that the same rules ought to apply. Whatever rules you developed after careful consideration here should be equally applicable to Government plans.

Mr. Moore. I do not see why we should interfere with private pension plans if we are not going to do the same thing to social security, and Government pension plans. I do not see any point for not doing it for one and for the other.

If you are telling me the administration will support that, you are being consistent and I will look at these things. If we have a double standard, I will not take a look at them until we are willing to consider making everybody equal.

Mr. Chapoton. I would just as soon stay out of that area now, but it would be hard to support these changes and not to say that they are equally applicable in all cases.

Mr. Moore. Then we can expect when Congress addresses changing the COLA system to a wage-based index and seeing that we put limitation on all retirement plans, that nobody will ever receive more than 100 percent of compensation. And also doing something to early retirement, we can expect support from the administration.

Mr. Chapoton. Yes, sir.

Mr. Moore. Thank you.

Chairman Rostenkowski. Mr. Bailey will inquire.

Mr. Bailey. This may seem like an odd question, but we have heard this cargo net concept described here today in terms of trying to come up with some revenue gain. There is no connection between this legislation and the desire to gain revenues from it.

I have heard rumors about tradeoffs between leasing and minimum corporate tax, alternative minimum corporate tax proposals from down in your area, are there?

Mr. CHAPOTON. Are you asking—whether the bill would raise revenue?

Mr. BAILEY. I wonder if it is going to fit in terms of the arithmetic with some of the rumors I heard about the tradeoff you folks are discussing down there.

Mr. CHAPOTON. I am not sure what tradeoff you are referring to.

Mr. BAILEY. Between the alternative minimum corporate tax and leasing?

Mr. CHAPOTON. This would not enter into that consideration at all.

Mr. BAILEY. But there have been those discussions, they have taken place?

Mr. CHAPOTON. There have been ongoing discussions about the impact of the minimum tax, about leasing and the effect on investments on those provisions and believe me, we have spent a lot of hours on the overall impact of those changes and whether adverse impact can indeed be avoided.

Mr. BAILEY. I wondered if the rumors were true. I thank you.

Mr. CHAPOTON. I would have to know more about the rumor.

Mr. BAILEY. You have answered my question, I thank you.

Chairman ROSTENKOWSKI. Mr. Shannon will inquire.

Mr. SHANNON. Just one brief question. This has to do with the Treasury's actuarial analysis. We will hear some testimony this morning that under the bill if pension benefits would begin at age 55, the bill's $90,000 limit would be reduced, actually reduced to a total of $27,000.

I find that kind of hard to believe. I was wondering whether the Treasury had done any actuarial analysis to confirm that or compute it?

Mr. CHAPOTON. I believe that would be based upon Pension Benefit Guaranty Corporation actuarial assumptions. Using other actuarial assumptions I have seen, the maximium benefit would be reduced at age 55 to $45,000.

We have not looked at that exhaustively. The benefits do decline dramatically because we are talking about 10 full years without contributions to and with payments under a defined benefit plan.

Mr. SHANNON. But a dramatic reduction of more than $90,000 to $55,000 rather than $90,000 to $27,000?

Mr. CHAPOTON. Yes.

Chairman ROSTENKOWSKI. Thank you very much, Mr. Chapoton.

Mr. Peyser, welcome to the committee. You may proceed with your testimony.

STATEMENT OF HON. PETER A. PEYSER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. PEYSER. Thank you very much, Mr. Chairman. And I welcome this opportunity to be with you and to be with my good friend from New York, Mr. Rangel, who is the sponsor of this legislation.

I must say at the outset that Congressman Rangel and myself have found probably very few areas of disagreement over the years that we have served in this Congress, and this may be one of the areas that we are going to disagree on.

I think that as a matter of record, it would be worthwhile in knowing that I spent my entire business career running over 20 years in the life insurance and pension field. And I basically, until I ran for the Congress starting in 1969, that was my livelihood and I sold these plans that we are discussing today.

I also served on the Education and Labor Committee, which coauthored the ERISA legislation in 1974. I presently serve as Chairman of the Task Force on ERISA, for reporting and disclosure. Now the aim of this particular task force—and we have been working for a little over a year now—of course is to see if we can remove unnecessary and counterproductive regulations in ERISA, and also see what we can do to cut back on the volumes of paperwork that have been heaped on pension plans and heaped on the Federal Government over the period of time that ERISA has been in force.

Obviously I am a strong supporter of ERISA, and I helped write the legislation. But on the other hand, what has happened with the Department of Labor and Internal Revenue Service, in its regulation and administration, I really believe has been a disaster. And I must say that the enactment of this legislation as presently proposed would basically wipe out the work of our committee for the past year, because of the incredible development that would have to take place of new regulation and superincreased paperwork over anything that we have today.

Now I have reviewed H.R.6410 and I am going to try to make a very brief summation of just some of the points that I see as a problem. And I do understand, and I am sympathetic with my friend from New York who is trying to get at some perhaps very direct abuses that may be existing, but I fear that the scope of this legislation is going to have the effect that instead of taking a rival shot at the target, of taking a buckshot and hitting every pension plan in existence today.

I am not sure it is going to be hitting in a very positive way.

Specifically, I am of the opinion that lower paid individuals which I have been deeply concerned about as has the gentleman from New York, Mr. Rangel, through the years in trying to protect and give benefits wherever possible ultimately may prove to be the biggest victims in this program. As you know, benefits in pension plans are in ratio, and the approval of plans have developed a ratio with the top levels of benefits.

And it is my firm belief that if we move ahead in decreasing the benefits of those recipients in the executive level, we will ultimately end up in decreasing the amounts of benefits that will accrue to the lower level.

I know, having sold these plans, while it may not be the way industry should act, and I do not think it is the way they should act, business looks at this and devises what they can, in effect, pay under benefit programs to the lower levels, based on the level that they are receiving. Unless you change those laws that affect that, I think we would see a reduction in this area.

I also believe in a separate advantage that the reduction of benefits under the 1-4 rule is likely to bring about a termination of a number of plans that do benefit lower paid workers, such as thrift and saving plans. Now a proposal to eliminate the cost of living adjustments, I believe would also have an adverse effect on the encouragement of pension formation and on the feasibility of plans themselves.

It would be possible, as I understand the legislation, for an employee, starting at the very early age of 25, earning only about $13,000, would basically, would have the pension restricted to that level by not being able to increase in cost of living as the year goes on, and by no longer indexing under the contribution under section 415, I think this is the effect it would have.

Now it is clear that all government plans, including our own, do include cost-of-living indexes. And it would be sort of hard to explain why private industry and private plans should not have one. I think again it would have an adverse effect and impact on small companies, particularly in hiring topflight personnel.

At this point I would like to simply mention a letter that I have received today from a small company in New York, and to quote one small part of the letter. It says:

> Our small company by virtue of its generous pension plans, which are completely funded by the firm and not at all by the employees, has been able to attract and hold many highly qualified people who might otherwise prefer the benefits and glamour of a larger and more prestigious company. We would be placed in a serious disadvantage if we were not able to offer such people a retirement benefit that would enable them to envision a postretirement income free of ravages of inflation. Moreover, what do we say to recent employees who were attracted to the firm for, among other things, our splendid pension plan?

I think this would typify the problems faced by many small successful businesses who would be confronted with this kind of a situation under this legislation. The changes in the loan provisions outlined in section 3 of the bill would basically eliminate the right of key employee participants in a plan, who are suffering from financial hardship for one reason or another, to be able to make loans.

Under the proposed changes, the top 15 percent of salaried employees would have to count the amount of the loan as ordinary income. It is very conceivable that major corporations could affect a tremendous number of employees. In smaller corporations where pension plans are with 50 to 100 people, we would find the problem of not making loans.

I would like to say at this time that in my experience in these kinds of plans where you have a committee that the person has to basically appear before to make these loans, is that a large number of these loans are made on the basis of having money to send a child to college, because the financial crunch and such, and heaven help us if the administration has its way and cuts out most of these loan programs.

But to make loans for college education, to make loans for homebuyers, that this has been one of the large segments of loan areas. I realize some people have used this system for other investments and for purchasing yachts what have you, which is certainly, I am sure that abuse may exist.

But it is not really the purpose that a lot of people—I would think a clear majority of people use in making loans under this program. You know the other 15 percent, you are hitting really the middle income, when you talk about that. And it would seem to me that that would not be the place where you want that impact made.

On the social security integration changes covered under section 4 of your bill, this is a highly complex situation that I submit would keep actuaries, lawyers, accountants, busy for many years, and would increase unfortunately the number of people we need at the IRS level to figure out what they were doing.

And I must say I really am not very qualified to speak on what that whole integration program would do. So I really would not say more than that on that issue.

On the provisions contained in sections 5 and 6 of the bill, extending H.R. 10 rules to qualified professional service corporations, I would like to say I am not interested in trying to create super programs to help a minuscule number of people. But it just seems to me that we would be enacting more stringent legislation dealing with professional and service corporations that could very well be discriminatory against one type of corporation as against another, and then leave the determination to the IRS to decide which corporation fell under those rules and which did not.

Now there are a number of those types of corporations that are listed in the legislation, such as health, law, engineering, architecture, accounting, actuarial, science, performing arts, at least and others, which it seems to me would be establishing a pretty discriminatory-type program against them.

With respect to the fringe benefits contained in section 7, once again it appears to me that it could very well result in the cutback of particularly in the area of group life insurance, it could result in the cutback of group life insurance for all employees, not just the top people, many of whom with this regulation in small plans, might say let's skip the whole thing, we will simply drop the plan and everybody is on their own.

Now, I understand the purpose of the chairman to get at the problems that are existing and there may be some excessive abuse areas. I do feel that this is not necessarily the way we should be going at it. I also understand the interest in getting money back to the Federal Government.

And in closing, I would really like to say that I think there are a lot more areas of getting real money back to the Federal Government. One of them would be in my opinon, in the deferral of the 1983 tax cut, I would like to repeal the windfall profits tax deductions that we enacted last year, which incidentally would reduce many more billions of dollars if this particular change went through.

I would suggest the changing of the safe harbor leasing provisions under the current laws that allow corporations to acquire liabilities of other corporations and take them tax free. This would produce many billions of dollars more and, you know, I could pick on one of my favorite targets, the Commodity Credit Corporation, which in the last 2 years has been given over $2.8 billion on interest from legitimate loans made to it with the approval of the administration.

Frankly, this would more than quadruple the amount of money that would come back under this proposal. So I do believe that private employee benefit plans have really served the community and the country very well over the years. And I would hate to see something happen that really adversely affected them in such a way that we would see little increase in new plans, curtailment of the old plans, and a reduction in benefits for the people who we are most trying to help.

I am not saying for a moment, I want it to be clear, that we should not look at the insurance industry and pension industry, to see if there are areas that abuses are such that we should act on, just the way we would look at any other business or organization in this country.

With that, Mr. Chairman, and gentlemen from New York, I want to thank you for giving me this time. I also, you know, admire the bringing of this out for discussion and exposure, and I hope maybe something good can come of this legislation.

But as you know, I do have certain problems that I expressed. I appreciate the gentlemen's time.

[The prepared statement follows:]

Statement of Hon. Peter A. Peyser, a Representative in Congress From the State of New York

Mr. Chairman and members of the committee, I want to thank you for the opportunity of testifying before your Committee on H.R. 6410 which would have a major impact on the future of pension plans in this country. First of all, I think you should know that I spent my entire business career of twenty years in the pension and life insurance field, leaving that field in 1969 to run for the U.S. Congress. I served on the Education and Labor Committee which co-authored, with your Committee, ERISA in 1974, and I presently chair the Task Force on ERISA Reporting and Disclosure whose aim it is to reform some of the administrative burdens that have been created under ERISA. We are now, after almost a year of study and hearings, nearing completion of our proposed legislation to simplify and improve ERISA reporting and disclosure.

The changes which are proposed in this legislation, including the changes in Section 415 contribution limits and the social security integration rules, would affect virtually all pension plans. I would ask you, Mr. Chairman, to be aware of the tremendous paperwork burden, which would result from enactment of these changes.

In the 10 years that you and I have served together in the Congress, there have been very few occasions where we have differed with one another. However, this may be one of them.

I have reviewed H.R. 6410, and I have reservations about its impact on the very people you and I have worked so hard for over the years. Specifically, it is my opinion that lower-paid individuals, who are presently protected under pension plans, would see their benefits reduced in ratio with the reductions in Section 2 of your bill, which decreases the limits on contributions and benefits. Having sold plans in the past, I know that the level of the lower-paid individual's pension is very much based on the pension provided to the more highly paid individual.

The reduction of benefits under the "1.4 Rule", is likely to bring about the termination of a number of plans that do benefit the lower-paid worker, such as the thrift or saving plans.

A proposal to eliminate the cost-of-living adjustments, I believe, would have an adverse effect on the encouragement of pension plan formation and stability. Specifically, an employee at age 25 earning only $13,000 would have his pension restricted as a result of no longer indexing the contributions under Section 415. As you know, all the government plans, including our own, include cost-of-living indexes. It would be hard to explain why private plans should not have one. I think there would also be an adverse impact on small companies in hiring top-flight personnel if you limit the benefits as you are suggesting.

The changes in the loan provisions, outlined in Section 3 of your bill, would basically eliminate the right of key employee participants in a plan who are suffering from financial hardship, for one reason or another, from being able to make these loans. Under the proposed changes, the top 15 percent of salaried employees would have to count the amount of the loan as ordinary income. In major corporations, this could affect thousands of employees. I think that maintenance of the current loan provisions, particularly when we are going through our current economic problems, is of the utmost importance.

On the Social Security integration changes covered under Section 4 of your bill, this is a highly complex situtation that I believe would keep actuaries and lawyers busy and would need a tremendous increase of IRS personnel to work out the adjustments. I must say I am not really qualified to speak on this particular issue.

On the provisions contained in Sections 5 and 6 of the bill, extending H.R. 10 rules to qualified professional service corporations, while I am not interested in giving special privileges to anyone, and perhaps there should be more stringent legislation dealing with professional service corporations, the proposed changes would appear to be discriminating against one type of corporation and make enforcement arbitrary and difficult.

With respect to the statutory fringe benefits changes contained in Section 7, once again, upon a first review, it appears that the result of these cutbacks for group life and health insurance could be the elimination of plans and the curtailment of increased coverage.

I do want to state that I am very supportive of the Chairman's purpose, which is to increase revenues to offset the burgeoning budget deficits. It is, however, my impression, Mr. Chairman, that we have available more attractive options for raising revenues such as deferring the 1983 tax cut, repealing the windfall profits tax reductions which were enacted last year and changing the "safe harbor" leasing provisions which currently allow corporations to acquire the liabilities of other corporations and in effect go tax free. These changes could produce significant revenue and to my way of thinking, would have no negative impact.

Private employee benefit plans have grown consistently in our country over the years and have served millions of our people well. The growth in pension plans has also increased tremendously the availability of investment capital for economic growth.

I am not for a moment saying that we should not look at the insurance and pension industry to see if tax abuses are taking place, but I am saying that we should study the situation very carefully and be sure of the impact on the employee benefit plans that will occur from such changes.

Mr. RANGEL. I want to thank you, my colleague from New York, as someone that has worked hard for the rank and file over the years. I had no idea that you had been in the pension business for so long. I assume that in the pension business, that you were about as successful there as you have been successful in the Congress in winning confidence of people and support of your ideas.

So your candor and honesty is just as consistent as your position has been in the Congress. And I think it is safe to say that you are testifying today, that if this bill becomes law, it certainly would unravel a lot of plans that you sold to a lot of people that are still out there, right?

Mr. PEYSER. I think you are correct. And I appreciate my good friend's nice comments, which I of course return to you. I also think it is important for the record to know that I am no longer selling pension plans, and have not been for nearly 11 years—12 years.

Mr. RANGEL. I know. But when you were selling these plans, I assume that a salesman or packager or whatever, they do not really go to the rank and file and ask what your pension needs. Basically you put together a package that the person buying it receives the maximum benefit with the least possible cost.

Is that true?

Mr. PEYSER. Yes, that is very definitely true. The type——

Mr. RANGEL. I should not expect a lot of rank-and-file people to be coming here saying, listen, do not bother my employer, because he is so vindictive that if you knock off $3 or $4 million from his plan, then he is going to just stop my plan. I should not expect to hear them say that.

But I should expect a lot of packagers to say that if you cap the accumulation of a small number of people, no matter how equitable it may appear, that a large number of people that buy these packages will penalize the lower paid employee by pulling out the entire system. That is the possibility.

Mr. PEYSER. Well, may I respond to that in this way? See, many of the plans, when you get into the numbers of thousands and hundreds of thousands of plans in this country, are sold to businesses that are 25, 50 or 100 employees. They are small plans in the concept of the General Motors or the other major plans. Those are the plans that I personally worked with.

And when you go in to sell that plan, obviously the executive, the people who own the company, are very interested in their benefits. And I think we all understand that. But every one of these plans has to be approved by the Internal Revenue Service. And the Internal Revenue Service, which has been very stringent in its control of these plans, having appeared before them and having to sell them that this plan conforms with the rules, are watching to see that we are not somehow discriminating in a percentage ratio against that lower paid employee.

So I guess what I am saying is that the ability to sell those plans, very much gets related to what that top person gets.

Mr. RANGEL. There is no dispute with your testimony. No one is saying that when these people take advantage of the law they are committing a crime. The question of loans, you seem to be concerned that the thrust of this bill is just to eliminate abuse of loans. That is not what I had in mind.

I just do not see how you could support a program where someone can take $30,000, deduct it, not pay taxes on it, put it in a retirement pension plan, allegedly to secure their future for their wives and their families, and then the next day take it out, to send their kids to college.

Now, it is not—it is no longer a pension plan. It is your money. But I just do not see how you would believe that this type of thing is good national policy. I do not care whether it is used to invest in business, to send kids to school, or to buy a home. You work for the money, it is your money. The only thing this bill does is say you pay taxes on it.

Mr. PEYSER. In responding to the gentleman on that, I am thinking in terms of corporation, not with two or three people, where the one person puts in all of the money and then takes it out, but I am talking about corporations that may have 50 employees, and when you take the top 15 percent of those people, you are dealing with people perhaps who are earning $35,000, $30,000 a year.

And these people, believe me, do not have that kind of money in the pension plan we are speaking of, but they may have accumulated over 4 or 5 years or 10 years, $15,000, $20,000, maybe even $30,000 in cash in the plan and suddenly they have a need and it is those people I am speaking of, and I recognize and I am not arguing really with the example you are citing, but I am saying your legislation also affects the people I am talking about who are the people who are the earners of $30,000 and $35,000, maybe even $25,000, who suddenly need that money.

Mr. **Rangel**. If they are not in that percentage of highest paid employees——

Mr. **Peyser**. They are in the 15 percent, they are in the 15 percent. That 25-life or 50-life plan, they are in the 15 percent.

Mr. **Rangel**. The last question is on the question of indexing, there is no difference between the congressional plan and this plan, both plans have caps. You could index all you want under the legislation except you have those caps for the benefits.

Mr. **Peyser**. But if we impact the cap on the benefit to the degree we say we are not going to index any further because we already reached the cap, you reach the cap sooner and that is the end of the indexing.

Mr. **Rangel**. That is what we do in Congress, same thing.

Mr. Pease.

Mr. **Pease**. Thank you very much, Mr. Chairman. I would like to begin by commending the author of the bill for bringing this situation to our attention so we can study it. It is good to have such a large audience keeping an eagle eye on what Congress might do with these benefits.

Mr. Peyser, I was interested in your testimony. Can you tell us from your own experience what the basic thrust is when a person goes in to sell a pension plan to a small corporation, what the basic pitch is, if you will, that you make to the owner of the corporation.

Mr. **Peyser**. Well, the initial thrust is for the salesman to make a living, that is the initial thing. After that, if he gets in to see this client, what he outlines is one, the tax advantages of putting a plan of this nature in and what the plan can do for him. This is talking—one of the things I learned in selling pension plans was not to talk to somebody in a corporation with say 25 to 50 employees, not to talk to somebody down the line in the management level, but to talk only to the president, the chief executive officer. Because obviously, I have to get that person interested in that plan.

I can tell you the initial reaction when you go in in selling this type of product, like anything else is well, I have got stocks and I have got bonds and I have got all of these other things, and I really do not need it. Then you have to show him how under the law he can participate and gain certain advantages that the law has provided for him, in order that other people in the plan as well may be covered, people who work for him.

So you outline his benefits and top management benefits and then you outline the benefits to the people who are the lower paid people in that organization. And that is the system that you would use in approaching and getting the interest in the plan.

Mr. **Pease**. If there are a lot of employees, 40 or 50 employees of the corporation, in a very closely held corporation, and one or two owners, can you really show that it is in the owner's best interest to buy a pension plan like that, rather than just to take the money as dividends and pay it themselves?

Mr. **Peyser**. Yes, you sure can. And not only that, you do have a very important fact that I probably should have stated initially, is that you can show that small corporation by the putting of a plan of this nature in, how he can hold his upper management people and he can attract other management people, because of the plan.

I can tell you today a small corporation that—and a good corporation that does not have an incentive plan, with pension, profit sharing or what have you, has a very tough time in attracting any talented material. So that is becoming increasing evident.

So you do sell that concept and let me say a great many employers do want to do something positive for the people that are working for them. And they feel that there is a certain responsibility but obviously they also are very interested in what they are going to get out of it.

Mr. PEASE. Thank you.

Finally, I think you mentioned in your testimony that you think there may be better ways to get revenue than this, including deferral of third year tax cut. It seems to me that there is at least a perception abroad that this pension system allows fairly well-off individuals to defer a good deal of their income and it appears to me that in the trade-off that you mentioned, it might appear to the public that we are maintaining a tax shelter for wealthy people, while taking away a tax cut for rank and file ordinary taxpayers.

That does not put us in sort of a difficult political position?

Mr. PEYSER. I would say to the gentleman that if the tax cut program we are talking about reached the rank-and-file, I might not be so in objection to it. But the particular tax cut benefits a very limited number of people all on the upper end of the scale. I do not want them to have both benefits.

Mr. PEASE. In the third year you would agree that most of the damage of skewing the tax cut of the President's program to the upper income program occurred in the first year. The third year is not so great.

Mr. PEYSER. I respect the gentleman's opinion on that. I think the whole tax program we went into is a disaster to start with, and I voted against it, so I guess we are of a different opinion on that issue.

Mr. PEASE. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Duncan will inquire.

Mr. DUNCAN. I have no questions. I would like to just thank my colleague.

Chairman ROSTENKOWSKI. Mr. Moore will inquire.

Mr. MOORE. I want to indicate an interest in the gentleman's comments, especially concerning the loans, the feature of this bill that would take care of that.

Does the gentleman think it is possible to come up with a satisfactory limitation on what the loans can be made for?

Mr. PEYSER. Well, let me say——

Mr. MOORE. You mentioned education, or buying a home, for example.

Mr. PEYSER. I think that by regulation, while we have not done it that specifically, this would—I would certainly be supportive of such a move. I think that the—on many of the plans, in fact probably most of the plans, when you want to make a loan, you have to set forth your reason for that loan and generally, if the loan were to buy a fur coat, for somebody, I do not think they would approve that loan. They would simply say, you know, if the committee were functioning, that that would not be a loan that they would say is approvable.

But education, home buying, illness, this type of thing, I think we ought to keep the door open for that person, particularly today. Because today there have been so many people caught in the economic problems that to have $20,000 or $30,000 or $40,000 in a plan and have your son or daughter ready to go to college and then you cannot get the money out to use it, I mean you would not use it normally but as long as you have got the right to use it, it certainly, I think, would be a terrible injustice not to let that person have it.

Mr. MOORE. Harkening back to your 20 years when you were in this business, did you find that this was a limitation to people getting into these plans, the fact that they could not get the money out, or since they had been able to, do you find it an attraction of being able to get an employee to participate?

Mr. PEYSER. Well, to tell the truth, I do not think the average employee, even in the upper 15 percent, when they come into the program, are really that tuned in to the nuances of the program. Once they are there and they have a need, they become very aware of it. So I do not think it has played a role, let's say, in the starting of a plan for the individual in that billion dollar management area that would be affected by that change.

I am also convinced that the executive is always going to find a way, if they need that money for college education, they are not going to get that money anyway. I do not think it has a tremendous impact until the need exists. Once that need exists, it will have a real impact.

Mr. MOORE. Last year I introduced H.R.1250, which expanded the amount of money one can deduct for individual retirement account contributions. Most all of that wound up in the tax bill that we passed last year.

One provision did not wind up being law. That was one to make it possible to borrow or to withdraw, without paying a penalty, funds from an individual retirement account for the limited purposes of education and purchasing the first home.

And that did not pass. We were led to believe—I was—by the industry people who worked with me in putting together that bill, that allowing this type of limited purpose borrowing would make individual retirement accounts more attractive to the average worker, whose concern is that their IRA money may be tied up forever.

Do you agree with that concern?

Mr. PEYSER. I would think that that is far different when a pension plan is sold to employees, they know everything that is being paid into that. I would tend to agree with the gentleman, that with stipulations of limited use of that money, that I would like to see it made available at current interest rates.

Mr. MOORE. If we were to move in that direction, which I would like to see us do, so we can remove any impediment a potential worker would have in going into an IRA, to make it possible to go into it understanding that if he has these problems there is a way for him to utilize the funds, that it would be inconsistent with that movement to turn around and move in the direction of this bill——

Mr. **Peyser**. Of course it would be.

Mr. **Rangel**. Mr. Bailey?

Mr. **Bailey**. I have no questions.

Mr. **Rangel**. Mr. Fowler?

Mr. **Fowler**. I have no questions.

Mr. **Rangel**. Let me thank you again. Let me ask you one last question.

If I came to you as a fellow making a couple hundred thousand dollars a year, and said first of all I want you to sell a plan and get credit for it, but basically I have a lot of things I want to do. I want to expand my business, send my kids to college and I would like a yacht.

But I also want a retirement plan. I am asking you whether, without violating the law, I could take $30,000 or $40,000, defer tax payment on it, put that away under the law. Then at the same time, Mr. Salesman, the next day take that $30,000 or $40,000 out, take care of my obligations, invest a couple thousand dollars, and still shelter the income. Could I do this under any of the plans that are available that you are selling without violating the law, while keeping my cost down and benefits to the rank and file at the very minimum?

Do you have anything like that in your portfolio?

Mr. **Peyser**. Mr. Chairman, if I can respond to that in my area of practical experience, I want you to know that that really—you could not do that when I left the business, back in 1969. It would not have been possible to do.

But I was never directly involved in that kind of a sale. If it had been possible to do, I do not doubt that as a sales person I would have been working to do that under the law.

Mr. **Moore**. Taking the personality out of it, which I should not have done, but it was just for the purpose of the hypothetical, the law today as you understand it, could you do exactly what I said?

Mr. **Peyser**. You could come very close to doing what you indicated at that time. As I said at the outset, Mr. Chairman, some of these areas that you are targeting, I think have merit in really going—undergoing a close look to see how you handle that. I guess my problem, as I stated, is that I feel that the scope of this is so overly broad that it impacts many people that I do not think should be hurt by this.

Mr. **Rangel**. Let us work together because you know that none of the members of this committee would want people to be hurt, especially the rank and file, because of the abuses of a few.

I thank you for your candor, your honesty in your testimony and your contribution.

Mr. **Peyser**. Thank you very much.

Mr. **Rangel**. We have a panel that will be testifying next. The American Society of Pension Actuaries, president, Gerald Facciani; the Association of Private Pension and Welfare Plans, David Marshall, corporate manager; ERISA Industry Committee, counsel Jerry Oppenheimer; National Retired Teachers Association and American Association of Retired Persons, James M. Hacking; and

Profit Sharing Counsel of America, Walter Holan, accompanied by Larry Shapiro as counsel.

I would want the panel to know that this committee always extends the privilege to its witnesses to submit their entire written testimony for the record, and to highlight that testimony before responding to questions.

That is particularly important. The committee is very anxious to deal with specifics rather than broad concepts, and where we have the benefits of your thoughts and those who put together the pension packages, it might be to your benefit to give examples specifically as to where the inequities would lie.

Do you have a statement, Mr. Duncan?

Mr. DUNCAN. No, thank you.

Mr. RANGEL. Mr. Facciani.

STATEMENT OF GERALD D. FACCIANI, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. FACCIANI. I appreciate the opportunity to testify on behalf of the American Association of Pension Actuaries. We provide consulting, administrative, and actuarial services to approximately 30 percent of America's 600,000 retirement plans.

H.R. 6410 is a bill which, if enacted into law, will unquestionably result in massive plan termination and incredible administrative cost, particularly for small business.

This is not in the public interest, in our opinion. I will be happy to answer any questions the committee has about our technical written testimony or these remarks.

On May 6, two weeks before this bill was presented on the House floor, the Joint Committee on Taxation [JCT] requested from our Society numbers which would illustrate the difference in employer deductions under the bill's code section 415 related items. Using data which ASPA compiled for the President's Commission on Pension Policy, it was calculated the drop in benefit and contribution levels, the change from 1.4 to 1.0 and the elimination of pre-age 65 funding would reduce qualified plan deductions by about $2 billion.

Applying a tax rate of 40 percent to these numbers, the JCT assumed there would be an $800 million annual revenue gain by making these changes. However, what has not been made public are the other estimates and information which has developed for the JCT namely, one, that over 30 percent of all companies sponsor more than one retirement plan, and that the termination of many of these plans would inevitably result from these proposals.

Two, that this rash of terminations would lead to the wholesale disenfranchisement of an estimated 350,000 nonshareholder employees just by the change from 1.4 to 1.0.

Three, that based upon a survey we did in 1978, which I might add as the last attempt to redefine integration through a theoretical rather than technical approach, as many as 41 percent of the integrated plans served by ASPA members indicated they might terminate if these proposals were enacted into law.

All of these numbers were in the possession of the Joint Committee well in advance of the introduction of this bill on the House floor, wherein it was stated in the Congressional Record and I quote, "Those who benefit most from these subsidies, due to their tax bracket, are the highest paid employees and owners."

I submit to you, Congressmen, that the high paid professional or businessman—who worked hard to get where he is and realize the American dream—will not suffer as a result of these proposals. He has plenty of financial advisers to help him, in other areas, and he can invest on his own behalf in personal tax shelters to the exclusion of the rest of his employees.

The people who will suffer from this bill are the other employees, primarily employees of small business, who are able to have significant contributions made on their behalf in private plans, and who have no alternative form of savings as does this bill's so-called fat cat.

At a time when retirement savings is being promoted in an effort to help take the heat off social security, at a time when 86 percent of all new jobs in the private sector are being provided by small business, at a time when small business is already saddled with overregulation, at a time when an additional annual injection of $2 billion of capital is desperately needed for investment in this country, ASPA finds H.R. 6410 to be squarely opposed to the public interest.

I do not want to exceed my alloted time, so let me illustrate one more example of how this bill flies in the face of public interest. Consider if you will the administrative expense that will have to be borne primarily by small business. As I mentioned before, there are approximately 600,000 qualified plans in this country, over 90 percent of which are small plans. Each of these plans will have to be reviewed to determine whether or not the employer wishes to maintain the plan. If an employer wishes to continue a plan, it will probably have to be completely restated. If an employer wishes to terminate a plan, he will have to bear the brunt of that cost.

Realistic cost estimates are that the review and restatement process will cost, on average, at least $2,000 for the typical small plan, and significantly more for the large plan. Assuming no plans are terminated, a naive assumption at best, the cost to review and amend every plan in America, should run at least $1.2 billion.

Considering the cost to terminate a plan is two to three times greater than to restate one, this bill could present a price tag for business, approaching $2 billion. Frankly, ASPA's membership will get rich if this bill becomes law. We would rather see the private pension system preserved.

The introduction of this bill in the Congressional Record quotes President Kennedy as saying, "A rising tide lifts all boats." The only question we have is, how many retirement plans and the people they cover will drown in the process?

Thank you.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN SOCIETY OF PENSION ACTUARIES

The American Society of Pension Actuaries is a national professional society whose 2,000 members provide actuarial, consulting and administrative services to approximately 30 percent of the qualified retirement plans in the United States.

It is our position that the enactment of H.R. 6410 would do severe damage not only to the private pension system, but also to the overall economy of the United States. The enactment of this Bill would discourage the establishment of new plans and encourage the termination of existing plans, result in hundreds of millions of dollars in additional expenses to amend the pension plans which continue in existence, put additional pressure on the already beleagured Social Security System, and adversely affect the supply of capital. It is this latter point on which we shall initially focus.

Private pension plan reserves now total approximately 350 billion dollars, and provide a vital source of long term capital for American industry. The inevitable consequence of H.R. 6410 would be a curtailment of the growth of this investment pool in view of the diminished incentives to establish or continue plans. The impact of this would be most severely felt in the small business area, since a small business typically has the greatest need for capital and the most difficulty in obtaining it when capital is in short supply, as it is today. When these facts are considered in light of the contributions of small business to our economy, the seriousness of taking any action that would adversely affect the growth of capital generated by the private pension system becomes apparent. As noted in the April 1, 1980 report to the President of the White House Commission on Small Business, new and existing small companies in recent years have provided 86.7 percent of the nation's new jobs in the private sector. Furthermore, a study by the Office of Management and Budget shows that more than half the major technological advances in this century originated from individual inventors and small companies. It is certainly true that a shortage of capital affects large as well as small business. The point we would like to emphasize is that a capital shortage impacts most severely on small business, and small business plays a vital role in technological innovation and new job creation.

At this point we will comment on specific aspects of H.R. 6410.

I. DOLLAR LIMITATIONS AND 1.4 RULE

H.R. 6410 proposes to cut back the dollar limit on annual pension benefits under qualified defined benefit plans from the present $136,425 to $90,000 and eliminate the cost of living escalator. The dollar limit on annual additions to defined contribution plans would be reduced from the current $45,475 to $30,000, and the cost of living escalator would be eliminated. It must be remembered that pension plans are already subject to extensive non-discrimination requirements, and that benefits or contributions cannot discriminate in favor of the highly compensated (or officers or shareholders). Devising a statutory scheme, as H.R. 6410 would do, that ensures the pensions of those at the upper echelons are disproportionately smaller as a percentage of compensation that those at the lower echelons will create a significant disincentive to establish or continue plans, or to provide increased benefits under plans that are continued. Furthermore, it should be noted that elimination of the cost of living adjustments to the 415 limitations will ultimately impact on the pensions available to the vast bulk of employees. Under a typical pension program, a 25 year old employee would have his pension limited by the cost of living repeal if he currently earns $13,000.

We note that governmental plans including the Congressional, Civil Service, and military retirement plans have cost of living indexes, yet H.R. 6410 would eliminate the indexing available under Section 415. We do not understand this disparity in treatment.

H.R. 6410 would reduce the allowable limit in cases where there is both a defined benefit plan and a defined contribution plan from the ratio of 1.4 to 1. The bottom line to such a limitation is that if an employer has insufficient incentive to establish or continue a second plan, he will not do so, and the effect will be to disenfranchise the rank and file employees who would otherwise be covered under the second plan.

II. APPLICATION OF CERTAIN KEOGH RULES TO PROFESSIONAL SERVICE CORPORATION PLANS

H.R. 6410 proposes to apply the more restrictive Keogh rules on contributions and benefits, participation, vesting, and distributions to "personal" service corporations. The Bill singles out nine identified service providers—doctors, lawyers, engineers, architects, accountants, actuaries, actors, athletes and consultants—for this special treatment. We believe this singling out of personal service corporations for special adverse treatment is irrational. We do not understand why an individual employed by a corporation should be treated differently by virtue of the nature of his profession. Again, the effect of these provisions will be the same as the provisions previously discussed—create a disincentive to create or continue plans, and put more pressure on the Social Security System to provide benefits that would otherwise be provided by the private pension system.

III. INTEGRATION

The current Social Security integration rules were developed over a long period of time, and while complex, are understood by the professionals in the pension industry. Not only would the proposed changes in these rules disrupt orderly patterns of funding for those employers maintaining private pension plans, but also plan sponsors will be forced again to "bite the bullet" of substantial additional administrative costs to study, amend or terminate existing integrated plans. We think it is a particularly inopportune time to be suggesting changes in integration since the National Commission on Social Security Reform, which is currently studying Social Security and its relation to the private pension system, will not conclude its study until December. Regarding the specific proposal, we have the following comments.

(1) The defined benefit plan rules laid out in H.R. 6410 discriminate against the final employer of an employee; (a) Since the great majority of plans are based upon "final pay" formulas, a generally greater burden of income replacement is already on the last employer; credit for Social Security should be commensurate. (b) The proposed contribution-based offset rule will further exacerbate the relative funding cost of providing meaningful levels of pension benefits to lower and middle-income persons entering employment at later ages.

As a practical matter, these factors may combine to lead to hardship for older persons attempting to get jobs, because of excessive pension costs.

(2) The integration provision discriminates against long-service rank and file employees; The contribution-based Social Security "offset" will be disproportionately greater for long-service workers and thus plan benefits for them will be diminished.

(3) The integration provision of the bill would virtually wipe out the accrual of benefits on termination prior to age 50 for persons entering employment at younger ages. This would completely contradict the vesting standards of ERISA.

(4) The integration provision ignores the fact that the Social Security benefit formula, one half of which is employer financed, provides a higher percentage of pay with respect to lower brackets of covered compensation.

(5) The so-called "safe harbor" alternative would produce tremendous disparity of treatment between participants situated as to income level, but of different ages.

(6) Impact of proposed changes upon government revenues is uncertain and requires extensive study.

IV. ESTATE TAX PROVISIONS

The bill would limite to $500,000 the estate tax exclusion applicable to amounts payable under a qualified plan. This exclusion is an incentive to establish a qualified plan, and as with every other item discussed so far, the proposed restriction on this exclusion would be a disincentive to establish or continue qualified plans. As we have previously stated, the rank and file employees will be harmed by reduced coverage under the private pension system if incentives to establish and continue such plans are diminished.

V. LOAN PROVISIONS

With respect to loans to key employees H.R. 6410 would apply Keogh plan rules to corporate plans. Loans from a corporate pension plan to a key employee—officers, 5 percent owners, or highly paid individuals—would be treated as a distribution from the plans and be considered as ordinary income to the employee.

Loans to employees are currently permitted under nondiscriminatory standards that require the loans to be reasonably and adequately secured. The anti-loan provisions of the Bill create numerous problems, including:

(1) Prohibiting loans to key employees will cause most plans to prohibit loans to rank and file employees. The inability of rank and file employees to borrow from their plans may aggravate their existing financial difficulties.

(2) The definition of "key employee" is arbitrary and irrational. The top 15 percent of employees will often include many rank and file employees. For large employers thousands of employees will be "key employees."

(3) The broad prohibition against loans in cash or deferred plans will discourage younger and lower paid employees from accumulating funds for retirement.

(4) The ability to borrow encourages employers to adopt plans and encourages employees to participate in plans. Loans enable employees to have access to a ready loan source in times of hardship or other financial emergency.

VI. CLOSING REMARKS

We see many problems with H.R. 6410 rules concerning statutory fringe benefits. However, since the primary concern of our organization is pension plans, we will defer to others to detail the problems such changes would create.

H.R. 6410 would make dramatic changes in the rules under which private pension plans operate after employers have spent billions of dollars to adjust to the changes imposed by ERISA and MEPPA. Not only do we believe these changes are extremely harmful in and of themselves, but also the imposition of any such dramatic changes so rapidly after the passage of ERISA and MEPPA would create a strong element of instability in the statutory environment, and this is counter-productive to the health of the private pension system.

Mr. **RANGEL**. Thank you.

Would your position be the same as relates to the administrative cost, if we were doubling the amount your clients could shelter in terms of income?

Mr. **FACCIANI**. Excuse me, I did not understand the question.

Mr. **RANGEL**. You are concerned about the administrative expenses of making any changes. Would your position be the same if this committee was talking about removing the cap and allowing your clients to double the amount of money they could shelter and not pay taxes on?

Would you still say the administrative costs are so prohibitive that you would be against that type of a thrust?

Mr. **FACCIANI**. If you remove the cap, you really do not have any administrative costs except maybe a simple plan amendment.

Mr. **RANGEL**. If we were to increase that cap on it, would you still have the same position about the cost?

Mr. **FACCIANI**. If that one change were made, there really would not be any administrative cost increase.

Mr. **RANGEL**. So the caps are the ones——

Mr. **FACCIANI**. I am saying the bill as a whole, would entail the complete restatement of these plans.

Mr. **RANGEL**. Thank you.

Mr. Marshall.

STATEMENT OF DAVID MARSHALL, CORPORATE MANAGER, BENEFITS, SUN CO., INC., ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, ACCOMPANIED BY HOWARD WEIZMANN, COUNSEL

Mr. **MARSHALL**. Mr. Chairman, members of the committee, my name is David Marshall representing the Association of Private Pension and Welfare Plans. I am accompanied by Howard Weizmann, pension attorney.

We have submitted written testimony at length which provides detailed information on our opposition to H.R. 6410. At this point I would really like to take a few moments to emphasize a few of our concerns. At the same time, I would like to provide some detail.

First, Sun maintains planned benefit plans and defined contribution savings plans for approximately 16,000 employees. Our understanding of the new limitations contained in H.R. 6410 is such that rank and file employees would be hurt most severely.

For example, we have had time to do an analysis based on our understanding, and we have distributed, I believe this morning, a chart that indicates the impact of the bill. In this analysis, we find that 100 percent of our employees below age 25 would suffer reductions in pension benefit accruals.

Between the ages of 25 and 29, 99 percent would be affected; between the ages of 30 to 34, another 99 percent of that population would be impacted negatively; throughout the entire spectrum of Sun's employee population, 55 percent of our employees would be impacted negatively with respect to the provisions of this bill.

[The exhibit referred to follows:]

IMPACT OF H.R. 6410 REDUCTIONS ON EMPLOYEES OF SUN CO., INC.

Sun maintains a defined benefit pension plan and a defined contribution savings plan for 15,570 employees. The new limitations contained in H.R. 6410 would have the effect of reducing benefit accruals for 55 percent of all participants. Following is a breakdown, by age, of impacted employees:

Participants whose benefits would be limited

	Percent
Age under 25	100
25 to 29	99
30 to 34	99
35 to 39	90
40 to 44	51
45 to 49	20
50 to 54	6
55 to 59	1
60 and up	0

These data assume the proposed reductions in sec. 415 limits and the value of post retirement medical coverage. On a composite basis, the "average" Sun employee who would suffer these reductions is age 32 with 6.2 years of service and currently earns $28,700 per year.

Mr. **MARSHALL**. This is, in our judgment, damaging to Sun's basic philosophy in the retirement income area. We would further like to point out that Sun's defined benefit plan is its primary source of retirement income to employees.

In 1975, Sun instituted a savings program, a defined contribution thrift plan providing employer contributions which are fully matched by employee contributions. In order to foster employee savings and supplement retirement benefits, the reductions contemplated under this bill, we believe, would force a curtailment in these contributions and reduce an employee's incentive and ability to save for retirement.

This occurs at a time when Sun and its employees are exploring new ways to protect the value of retirement income from the ravages of inflation. At the same time, we occur with other testimony to the extent that if pension benefits for highly compensated employees are scaled back by this legislation, this will tend to result in across-the-board reductions to rank and file employees.

With respect to the provisions for the social security integration, we have one concern, that the existing long-standing rules concerning social security integration have been integrated into basic plan design and costing. While we are not entirely clear with respect to the details of the new integration rules, it appears to us that they have been proposed without adequate prior study, and as a consequence may cause unforeseen and undesirable results.

For example, by using the simulated annuity approach based on social security taxes paid, the bill would seem to skew benefit accruals in favor of younger employees.

The final point I would like to emphasize concerns administrative costs. First, it seems clear that the bill as it now stands would require major amendments to every qualified plan. This would entail significant actuarial legal and other costs.

Second, we believe there would be a vast amount of unproductive employee time required to learn and to administer and to communicate to employees provisions of the plans under the new rules.

Third, the integration of the new rules into existing programs would undoubtedly create complex grandfathering clauses which would require in essence the administration of two separate programs for pre-bill and post-bill employees.

Finally, it has taken from the passage of ERISA until now to sensitize service providers, employees, trustees and administrators, and even employees to the requirements and rights accorded under ERISA. Now in one bill we feel Congress threatens to undermine this study progress and make us start anew.

That concludes my comments.

[The prepared statement follows:]

STATEMENT OF DAVID MARSHALL, ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

I. INTRODUCTION

The Association opposes H.R. 6410 on the grounds that it stands to weaken significantly the nation's private pension and welfare benefit systems and to affect adversely the future benefits of millions of American workers.

The National Association for Employee Benefits (APPWP), founded in 1967, is a nonprofit organization dedicated to the maintenance and growth of this country's private benefit systems. We are firm in contending that the future retirement income security of American workers and their beneficiaries is to be most effectively enhanced through the growth of the private pension system, in combination with strengthened personal savings and a financially improved Social Security system.

It is acutely ironic that at the very time when Social Security financing is under heavy pressure, and when this country's national savings rate is the lowest of the industrial nations of the world, anyone in the Congress would seek to diminish the vitality of the private system. And, yet, H.R. 6410 would have just that effect.

The Association represents some 600 organizations located across the United States. Our member firms include hundreds of plan sponsors—both large and small employers alike. Additionally, our membership includes leading organizations from every element of the employee benefits community which supports the nation's private benefits system: investment firms, banks, insurance companies, accounting firms, actuarial and benefit consulting firms, and various others associated with employee benefit plans. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by the private sector. As a result, the Association has ongoing access to the most concentrated and comprehensive benefits expertise and data available any where the world. Accordingly, we are well-equipped to comment on H.R. 6410.

It should be emphasized, from the beginning, that H.R. 6410 would negatively effect employees at virtually all pay levels. Clearly, H.R. 6410 would have an adverse impact on almost every pension and welfare plan being currently maintained within the private sector.

The bill substantially reduces benefits for the vast majority of employees, interferes with an employee's right to borrow pension funds in times of need, places arbitrary and irrational restrictions on plans maintained by certain types of businesses, adds new and unjustified restrictions on certain welfare plans, and seeks to alter complex and long established Social Security integration rules without adequate prior study. In addition, the Bill will cause existing plans to incur substantial administrative costs. As a result, the Bill will discourage the continuation of existing plans and inhibit the creation of new plans.

The President's Commission on Pension Policy, which recently performed a major in-depth study of the Nation's private pension system, strongly recommended in its Report that Congress enact new incentives to foster the creation and expansion of private pension plans. Such expansion would improve the retirement income of pensioners and reduce the burden on the Social Security system. The Bill ignores these recommendations and, without adequate study, would remove major incentives that have helped expand the private pension system.

The Bill, in the name of "equity," will not only disrupt the payment of pension benefits to thousands of employees, but will also decrease the valuable pool of capital made available by pension funds. In our opinion, given the complex and multifaceted nature of the private pension system and its close interrelationship with the Social Security system, it would be perilous to embark upon the sweeping changes proposed by H.R. 6410 without comprehensive and careful prior deliberations. It is particularly inappropriate that H.R. 6410 would be considered prior to the bipartisan report of the National Commission on Social Security Reform.

We are deeply disturbed by the extraordinary speed by which these hearings were scheduled and we urge the Committee to move slowly and deliberately in this area. This Bill, in any form, must not be adopted until its full impact on the private pension system has been analyzed. In any case, early analysis of the Bill shows clearly, and without question, that enactment of H.R. 6410 would damage the retirement security of all American workers and those who are dependent upon them.

II. ANALYSIS

A. Drastic reductions in contribution and benefit limitations established by ERISA.—Section 2 of the Bill would drastically reduce the corporate pension plan limits on contributions and benefits established by ERISA after thorough Congressional consideration and debate. Changing these limits will have far-reaching detrimental effects not contemplated by the drafters of the Bill since the reductions will not only decrease pension benefits for the highly compensated, but would also adversely affect the benefits of millions of rank and file employees.

In ERISA, enacted in 1974, after a decade of careful deliberations, Congress decided that $75,000 was the maximum annual benefit which could be paid under a qualified defined benefit plan and that $25,000 was the maximum contribution which could be made, on behalf of an employee, to a qualified defined contribution plan. Congress also provided in ERISA that these dollar limits should be adjusted annually for increases in cost of living. Currently, as a result of COLA adjustments, the defined benefit plan maximum is $136,000 and the defined contribution plan maximum is $45,475. Therefore, in real dollar terms, these maximums remain as enacted under ERISA.

H.R. 6410 would reduce the dollar maximums as follows: $90,000 for defined benefit plans and $30,000 for defined contribution plans. In current value, these new limits are substantially less than the limits Congress decided were acceptable for corporate plans just eight short years ago. No meaningful justification is given in support of the reductions in benefit and contribution limits. To say that such amounts are "excessive" is not only arbitrary and subjective, it also is completely inconsistent with prior Congressional action. The current limits are no more excessive than the original ERISA limits: indeed, they are the same limits adjusted for inflation. In addition, the Bill would, also without meaningful justification, replace the "1.4 rule" with a "1.0 rule" and eliminate COLA adjustments for the dollar ceilings.

The legislative history of ERISA is formidable and well-documented; years of study and deliberation, amplified by countless public hearings, preceded the decisions made by Congress in ERISA. Notwithstanding, this extensive prior examination, the full impact of ERISA on private pension plans was underestimated and numerous plans were terminated as a consequence of its enactment. Now, eight years after ERISA, we see the introduction of a Bill which was developed with what is clearly inadequate substantive knowledge or study. To make matters even worse, interested parties have been provided inadequate time to respond responsibly to H.R. 6410's potential ramification.

The benefit reductions proposed in H.R. 6410 should be rejected. As a general rule, pensions provided to lower paid employees must be equitably correlated to pensions provided to more highly compensated employees. The anti-discrimination rules applicable to qualified plans require that benefits and contributions for all employees be uniform in relation to their compensation. In our judgment, if H.R. 6410 is enacted, the pension benefits of higher paid employees, which necessarily must be scaled back to meet the lower dollar maximums, will in many cases result in corresponding reductions to pension benefits of millions of rank and file employees. To the extent across-the-board reductions in pension benefits occur, even greater pressure will be exerted upon the already troubled Social Security system.

The repeal of the "1.4 rule" will also have immediate and widespread adverse effects on rank and file employees. The 1.4 rule allows an employer with two pension plans—a defined benefit plan and a defined contribution plan—to use 140 percent (or 1.4) of the aggregate dollar ceilings which ERISA provides for those respective plans. Thus, for example, a plan sponsor may maintain a defined benefit plan which pays 100 percent of the maximum benefit allowed by ERISA and, in addition, maintain a defined contribution plan which permits contributions to the level of 40 percent of the ERISA maximum. Such an arrangement would satisfy the ERISA 1.4 rule. H.R. 6410, however, would replace the 1.4 rule with a 1.0 rule, which in our opinion, would force the plans sponsor in the foregoing example to either eliminate the defined contribution plan or reduce the benefit limit of the defined benefit plan in order to satisfy the 1.0 ceiling. In these circumstances the employer will likely abandon the plan which it considers to be the "supplemental" plan, which is generally the defined contribution plan. In addition, defined contribution plans are easier for the employer to terminate because they are not subject to Title IV of ERISA, and thus would not subject the sponsor to any termination insurance liability. Often, the defined contribution plan, because of its nature as a savings or profit-sharing plan (as opposed to a plan for retirement benefits only), will provide for faster vesting and therefore give greater rewards to short service employers. Thus, widespread termination of defined contribution plans would more severely affect young and low paid employees who are not as likely to remain with an employer long enough to vest in the defined benefit plan.

The floor statement made by Mr. Rangel (D-N.Y.) suggests that H.R. 6410 is intended to eliminate "excessive" pensions enjoyed by highly compensated employees at government expense. If that is the Bill's intention, it is this Association's view that the provisions of the Bill will go too far in their application. We have statistics which show that many low income employees will be adversely affected by the benefit reductions made by H.R. 6410. For example, an employee age 25 and currently earning $13,000 per year, who presently participates in a defined benefit plan which provides a benefit equal to 1½ percent per year of final five year average compensation and a defined contribution plan in which the employer makes contributions equal to 3 percent of compensation, will have his retirement benefits at age 65 reduced by the provisions of this Bill. Under no definition can an employee currently earning a $13,000 annual income be called "highly compensated". It should be noted that the foregoing example assumes a 6½ percent per year salary increase standard, which is very modest by today's standards.

The cut-back in benefits for an employee earning $13,000 results from future salary increases without corresponding adjustment to the dollar limits proposed under H.R. 6410. Ultimately, the employee may not suffer a cut-back because Congress may adjust the limit in the future. However, the employee, in this event, will lose the security which Congress intended to provide through the minimum funding standards under ERISA. If Congress were to provide for ad hoc increases in the limit every time it is out-of-alignment with compensation levels, many plan sponsors will be unable to immediately fund the cost of such increases. This will produce a funding gap in pension benefits which is precisely the problem which ERISA sought to eliminate.

Cost-of-living adjustments in the retirement systems serves as an essential defense against the ravages of inflation. Retirees and older workers are the segment of society least able to cope with the difficulties encountered in an inflationary economy. The policy or protecting against inflation is reflected in governmental pension systems which provide for cost-of-living adjustments: congressional, military, and civil service alike. Elimination of the COLA for the private system is an unjust overaction. Arguably Congress may adopt ad hoc increases to restore the limits to their proper alignment, but such ad hoc adjustments have never worked equitably and efficiently in the past. Indeed, if the ad hoc increases worked in the proper manner, there would be no need to eliminate the COLA because ad hoc increases would produce the same result as automatic adjustments.

In addition, H.R. 6410 will force many employers to adopt "excess benefit" plans to pay employees the benefits which are denied them under the new § 415 limits. This would cause more pension benefits to be paid on an unfunded basis and thus would be in direct conflict with the intent of ERISA.

Viewed from a larger perspective, H.R. 6410 is diametrically inconsistent with this Nation's current fiscal objectives. The Social Security system is floundering and relief can come only from an expansion and improvement of the private pension system. This Bill, however, would result in reducing private pension benefits for lower paid employees and therefore create even greater pressure on the Social Security system.

The enhancement of capital reserves is another important objective which figures prominently in our drive towards a more stable economy and reduced unemployment. Private pension funds, with their more than $400 billion in collective assets, represent a major source of investment capital. This Bill, however, would reduce levels of pension contributions and thereby slow the growth of pension fund capital available for public and private investment.

Finally, it is well known that plan sponsors, ever since the enactment of ERISA, have seen the cost of establishing a plan climb steadily upward; for some, the costs became so burdensome that they were compelled to terminate their plans. This Bill would require substantial plan amendments and the engagement of professional advisors, not to mention the continuing need for employees of the plan sponsor to spend substantial additional time necessary to assure compliance. In addition, new and expensive software programs would have to be developed to monitor the larger number of employees who would be subject to the lower § 415 limits. The Bill will therefore add to the already heavy administrative costs which must be incurred by a plan sponsor. The simple fact is that the more money an employer must spend to maintain a plan, the less money is available for plan benefits.

For the foregoing reasons, we oppose Section 2 of the Bill.

B. Anti-loan Provisions.—Section 3 of the Bill would, for certain employees, treat bona fide loans from pension plans as taxable distributions. Furthermore, in the case of cash or deferred profit sharing plans, the Bill would treat a plan loan to any employee as a taxable distribution. There is no justification for treating a bona fide plan loan as a taxable distribution; substantively, it is no different from a bank loan secured by a pass book account or a loan against the cash value of an insurance policy. Accordingly, this Association opposes Section 3 of the Bill.

The Internal Revenue Service has for years treated bona fide loans from qualified pension plans as loans, and not taxable distributions, provided the loans were made on a nondiscriminatory basis. In ERISA, Congress expressly recognized this long standing practice by providing that a plan loan would not be considered a prohibited transaction so long as (1) the ability to borrow was available to all participants on a reasonably equivalent basis, (2) loans were not available to highly compensated employees in amounts greater than amounts available to other employees, and (3) the loan generated a reasonable rate of interest and was adequately secured.

This Association contends that any plan loan which meets the established IRS and ERISA standards should continue to be treated as such and should not be treated as a taxable distribution. Loans to employees are reasonable plan investments and plan fiduciaries should not be restricted from making such loans in situations where it would be prudent to do so. Oftentimes, loans to employees provide a better and more secure investment return than other plan investments. Moreover, the IRS and the Labor Department have adequate rules and enforcement powers to curtail abusive or "sham" loans. Until such time as these agencies prove incapable of responsibly overseeing this area, plan loans should be permitted as before.

The Bill purports to prohibit loans to "key employee" only, but in reality, such a prohibition will operate to the detriment of all employees. If key employees are unable to borrow from their plans, it is safe to assume that in many cases, plan loans will be eliminated for all employees. Many plan sponsors will feel compelled to eliminate loan provisions because of the administrative difficulties created by the "key employee" classification while others will eliminate the loan provision because it will not generally be applicable to all employees. The Bill defines key employee as any officer, more than 5 percent shareholder, and any employee in the highest paid 15 percent of all employees. In large companies, the highest paid 15 percent includes thousands of employees, many of whom earn $30,000 or less; moreover, the highest paid 15 percent classification will be constantly changing as employees come and go and therefore, in order to administer a loan provision, a plan sponsor must continually monitor the mix of its employees to be certain that the employee seeking the loan is not in the "key employee" group. This added administrative burden may cause plan sponsors to eliminate plan loans entirely; the impact of this will be felt most acutely by rank and file employees who depend on plan loans in times of financial hardship.

In the case of cash or deferred arrangements (CODA), the Bill would prohibit plan loans to all employees, regardless of their status. This "special" anti-loan rule for

CODA participants is wholly without foundation. Congress, by adding § 401(k) to the Internal Revenue Code in 1978, sanctioned the CODA and encouraged its adoption. There is nothing in the statute or its legislative history which indicates that Congress wanted to prohibit a CODA from offering loans to employee-participants. Indeed, it is well known that the CODA which Congress took as its model in drafting the 1978 legislation was the plan of the Eastman Kodak Company in Rochester, N.Y. The Kodak plan did then, and for many years prior, make loans to all employees.

Rank and file employees are encouraged to make elective contributions to a CODA if they know that such funds will be available for borrowing in time of financial hardship. If the CODA is prohibited from making loans, fewer rank and file employees will participate and therefore fewer will be saved for their retirements.

The bill assumes that plan loans are antithetical to retirement savings, but this is not so. Indeed, just the opposite is true. Under present CODA rules, for example, a participant who is younger than age 59½ and not disabled may only receive a distribution from his account upon separation from service or hardship. If loans are not permitted, a rank and file employee in need of funds will be placed in a difficult situation: if his need qualifies as a "hardship" (which under the proposed IRS regulations will be a very rare case) he can receive his funds, but is forced to pay tax on the amount distributed. On the other hand, if his need does not qualify as a hardship, his only means of withdrawing his funds is by quitting his job. In both cases, however, once the funds are withdrawn, there is no obligation to put them back into the plan and therefore it is likely that such monies will not be saved for retirement. Loans, on the other hand, do not place the employee in the same dilemma, do not cause him to receive a taxable distribution, and do obligate him to repay the amounts borrowed.

For the foregoing reasons we oppose Section 3 of the Bill.

C. Premature modification of complex and long-established social security integration rules.—Section 4 of the Bill would replace the long-established Social Security integration standards with untested rules that would be difficult for plans to administer and would, in too many instances, cause rank and file employees to receive a lesser benefit from their pension plan than under the existing system. We oppose Section 4 of the Bill.

Social Security integration is a highly complex area. The existing rules represent the product of extensive analysis by the Internal Revenue Service. Furthermore, these rules, although complex to the layman, are now well understood by the actuaries and benefit consultants who deal with them. Moreover, employers have relied on these rules for years in the design and funding of their pension plans. And finally, Congress, on at least three recent occasions (1966, 1974 and 1978) rejected proposals to change the Social Security integration rules. For the reasons set forth below, we urge Congress to reject the integration proposals made in H.R. 6410.

The National Commission on Social Security Reform is currently studying Social Security and its relationship to the private pension system. The Commission is scheduled to conclude its study this December. Legislation in this complex area should be deferred at least until the Commission has completed its study.

The Bill's premise for changing the existing integration rules is that the present rules allow "excessive reductions of plan benefits * * * for rank and file workers." No empirical evidence is presented to support this statement and, indeed, the sponsor himself is unsure of its validity. Mr. Rangel, in his May 19 floor statement introducing H.R. 6410, qualified his remarks in this context by saying merely that "some would argue that" the present rules allow for excessive reduction. Supposition is no basis for changing long-established rules and we urge this Committee to delay action in this areas until more definitive analysis has been made.

In place of existing rules, the Bill would offer two alternative standards for defined benefit plans: (1) the Social Security offset could be no greater than an annuity purchased with the employer FICA taxes actually paid for the retiring employee (hereafter the "actually paid" rule) or (2) a "safe harbor" rule which provides that benefits related to compensation below $30,000, between $30, 0 and $60,000 and above $60,000 may accrue at a 1:2:1 ratio. These alternative standards are put forward in the name of simplicity and precision, but, as will be shown, they will only introduce greater confusion into an area which is already very complicated.

The new rules, if enacted, would apply, in the case of a defined benefit plan, to any person who becomes a participant in the plan after 1983. Therefore, all employees presently participating in such plans and any employee who joins a plan between now and 1984 may accrue benefits under the existing integration rules. Under this arrangement, the plan sponsor would be saddled with the difficult burden of administering a plan with one integration rule for the pre-1984 participants and a different integration rule for the post-1983 participants. This may cause comparability problems and it will undoubtedly produce employee relations problems.

In addition, we have data which show that rank and file employees could suffer a greater offset in their pension benefits under the proposed rules than they would under existing rules. For example, under the "actually paid" standard, if employer FICA taxes are assumed to acccumulate at an 8 percent rate, all employees currently under age 55 who have in the past and continue to earn in the future an annual income which is equal to the Social Security taxable wage base would suffer a greater pension offset under the proposed rule than under the existing rule.

Inasmuch as no evidence has been presented to prove that the current integration rules are not working as intended, we urge that new rules not be enacted. For the foregoing reasons, we oppose Section 4 of the Bill.

D. Discriminatory application of harsh owner-employee restrictions to pension plans maintained by all partnerships.—Under current law, a partnership with "owner-employees" (individuals owning a greater than 10 percent share of the business) is subject to numerous special restrictions in the design and operation of its qualified benefit plans. The intent of such restrictions is to preclude manipulation of the plans by dominant partners. Such restrictions have never been applicable to partnerships which do not have owner-employees for the obvious reason that plans maintained by such firms are not as vulnerable to manipulation by dominant partners.

H.R. 6410 would, without any justification whatsoever, impose the harsh owner-employee restrictions on all partnerships, regardless of size. Thus, for example, a junior partner in a major national accounting firm, which has thousands of employees, would be precluded from receiving a plan distribution if he left the firm prior to age 59½. In addition, such a firm would be denied the right to have a discretionary profit sharing plan.

The "owner-employee" restrictions were, in this Association's view, arbitrary and unfair from the outset. The established antidiscrimination rules for qualified plans are more than adequate to curb any dominant partner abuses which may have arisen in context of plans for self-employed individuals. By extending the owner-employee restrictions to plans of all partnerships, the Bill would magnify the existing discriminatory treatment between plans maintained by partnerships and plans maintained by corporations. There has never been any justification for distinguishing between qualified benefit plans on basis of the manner in which the sponsor conducts its business. This Bill would enlarge the existing discriminatory treatment toward partnership plans and, with the exception of the increase in the deduction limitation (from $15,000 to $30,000), we oppose Section 5 of the Bill.

E. Discriminatory application of rules relating to pension plans maintained by self-employed individuals to plans maintained by personnel service corporations.—Section 6 of the Bill would treat all shareholders of "personal service corporations" as self-employed individuals for purposes of all pension and deferred compensation plan rules. A "personal service corporation" is defined as—any corporation the principal function of which is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics or consulting.

Thus the Bill would extend the already discriminatory rules applicable to plans maintained by partnerships to plans maintained by certain types of corporations. This is arbitrary and inconsistent with sound pension policy. The implication is that plans maintained by personal service corporations are in need of special restrictions which need not be applied to plans maintained by other types of corporations, e.g., companies which deal in the exploration, manufacture and distribution of products. There is no justification for making such a distinction and, in our judgment, the effect of these highly punitive restrictions will be the curtailment of benefits offered by plans maintained by personal service corporations to the detriment of rank and file workers.

In addition, the Bill will create new, complex and arbitrary distinctions in the law which will make plans more difficult to administer and will exacerbate the already formidable task of enforcing the revenue laws.

For the foregoing reasons, we oppose Section 6 of the Bill.

F. New and complex discrimination rules for statutory fringe benefits.—Section 7 of the Bill would establish new and complex nondiscrimination standards for many forms of statutory fringe benefits, including well established benefits such as health insurance and group life insurance. Our Association opposes the application of such rules because we believe that numerous problems will result.

By effectively limiting benefits for more highly compensated individuals, the Bill will result in benefit cutbacks or elimination of benefits for rank and file employees in important areas such as life insurance coverage. Moreover, by requiring equal dollar coverage for health insurance the Bill will greatly inhibit the expansion of health coverage to rank-and-file employees.

As is the case with most of the provisions in this Bill, no justification has been presented for changes in the long-established rules that currently exist. With respect to insured fringe benefit plans, underwriting and state law requirements prevent the occurrence of abuses.

Moreover, we believe that the existing rules which pertain to life and health insurance have been responsible for the extension of coverage to a broad segment of the work force. Restricting these provisions will have a highly detrimental effect on this important coverage.

For the foregoing reasons we oppose Section 7 of the Bill.

III. CONCLUSION

This Association is ready to support any reasonable proposal to expand pension and welfare plan coverage and improve benefits for rank and file employees. We do not speak for a single constituency; rather we represent a broad range of plan sponsors and professional advisors. If greater equity is needed in the delivery of pension and welfare benefits by the private sector, this Bill does not accomplish that goal. On the contrary, we believe that if this Bill is enacted, its provisions will inhibit the establishment of new plans, discourage the improvement and continuation of existing plans, and create greater inequity among plans based upon differences in the way the sponsoring employers conduct their business and upon the type of business in which those employers engage. Our membership is united in opposing this Bill and we urge that it be defeated.

Mr. RANGEL. Mr. Oppenheimer.

STATEMENT OF JERRY L. OPPENHEIMER, COUNSEL, ERISA INDUSTRY COMMITTEE

Mr. OPPENHEIMER. I am Jerry L. Oppenheimer, counsel to the ERISA Industry Committee, or ERIC as you may know it.

ERIC is an organization of some 100 major employers which maintain employee benefit plans. Boris Auerbach, Secretary and Vice President of Federated Department Stores in Cincinnati, is the chairman of ERIC and was here on Tuesday to testify on its behalf. Unfortunately, he could not return to Washington today so I will summarize ERIC's position.

The proposed legislation raises important, complex, and far reaching issues of social and tax policy. In the limited time which has elapsed since the bill was introduced and this hearing was announced, we have not had time to analyze the proposals thoroughly. Thus, my comments are general and with the committee's permission and consistent with your request, Mr. Rangel, for more specific information, we intend to file a more complete statement before the record of the hearing is closed.

In summary, ERIC opposes the proposed legislation. First, we are concerned that the bill would significantly reduce benefits for substantial numbers of rank-and-file employees. For example, one major employer has concluded that the proposed reduction of the limits on contribution and benefits would affect 68 percent of its employees.

To the extent that these benefits were replaced by supplemental unfunded plans, the bill would be inconsistent with the ERISA policy of assuring future payments of benefits by requiring current funding. This is contrary to the suggestion of some that this is a bill that would adversely affect only the well to do.

Second, by reducing contributions to retirement and savings plans, the bill would reduce long-term savings and investment capital. This seems particularly counterproductive at this time.

Third, eliminating COLA's would impose restrictions on beneficiaries of private sector plans which are not applicable to beneficiaries of congressional, civil service, or other governmental plans. This would be highly inappropriate.

Fourth, the bill contains a complex system to integrate social security and private benefits which, from preliminary analysis, would be costly and difficult to administer. Plans maintaned by ERIC members are integrated with social security, but they do provide significant benefits for substantial numbers of rank-and-file employees. The existing rule should not be altered in the absence of careful analysis.

Fifth, the abuse at which the antiloan or antidiscrimination provisions are directed is not clear. The service has adequate existing authority to deal with sham loans. The proposed prohibitions are overly broad and would create significant administrative burdens.

Sixth, the proposals would impose other costly administrative burdens. For example, as you have heard, plans and summary plan descriptions required by ERISA would have to be amended and costly pre- and posteffective date recordkeeping would be required. The additional costs could lead many smaller plans to terminate, and the creation of new plans would be curtailed.

Seventh, in sum, the bill would significantly weaken private sector plans at a time when social security is under growing stress.

I will be happy to expand upon these comments and to respond to questions as time permits.

[The prepared statement follows:]

STATEMENT OF THE ERISA INDUSTRY COMMITTEE [ERIC]

This statement is submitted on behalf of The ERISA Industry Committee (ERIC), an organization of some one hundred major employers which maintain employee benefit plans. In its oral testimony, ERIC opposed the adoption of H.R. 6410. This supplemental statement explains in greater detail the reasons for ERIC's opposition.

In summary, H.R. 6410 would adversely affect rank and file employees, would impose complex arbitrary, and untimely new rules for Social Security integration, would significantly weaken the private retirement system, and would impose unnecessary administrative burdens in employee benefits plans. It should be rejected.

I. REDUCTION IN LIMITS ON CONTRIBUTIONS AND BENEFITS

H.R. 6410 would reduce significantly the current maximum dollar limits on contributions to and benefits provided by qualified plans. It would further limit contributions and benefits by eliminating the "1.4 rule" for participants in more than one plan, by requiring actuarial reductions for benefits paid before age 65, and by eliminating the cost of living adjustment (COLAs) currently applicable to the dollar limits. ERIC opposes the proposals.

Congressman Rangel indicated that a major objective of his bill is "to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees". Instead of achieving this laudable objective, the bill would reduce benefits for substantial numbers of rank and file employees, decrease retirement security for all employees, create a distrubing incentive to terminate many plans, reduce long-term savings and investment capital, and significantly erode important ERISA principles and national retirement policy.

A. The Present Limits Are Appropriate and Should Not Be Modified Without Careful Analysis.—Eight years ago, after considerable study and debate, ERISA established a $25,000 limit on contributions and a $75,000 limit on benefits. The increases to the present levels have resulted soley for inflation.

COLAs were considered necessary to preserve the integrity of the limits in an inflationary economy, and inflation, while recently abated, still persists. The age 55 limit on actuarial reductions recognized that "early" retirements were (and are) common, especially for the rank and file. The average retirement age in large corporations is approximately 61. The "1.4 rule" recognized that defined contributions and defined benefit plans serve different needs and allows employees to enjoy the benefits of both. Most large employers and many smaller employers maintain both types of plans.

Qualified plans have long been subject to strict nondiscrimination requirements. The benefit levels for the highest paid can be no higher than those for the lowest paid. Indeed, when combined with Social Security, the benefit levels for the higher paid are often less than for the lower paid.

The Proposed limits are arbitrary. Before the existing limits are modified, a careful analysis of the effects must be made.

B. The Proposals Would Reduce Qualified Plan Benefits of Rank and File Employees.—In the absence of certain factors to be established by Treasury regulations and in the short time available since the bill's introduction, it is difficult to assess the precise effects of the proposals on particular plans or employees. Nonetheless, it is clear that significant numbers of middle and lower income employees would be adversely affected by the proposals.

One employer has concluded that the qualified plan benefits of 81 percent of 32,000 current employees would be reduced by the proposals.[1] Appendix I demonstrates that over 12 percent of this employer's employees retiring in 1983 would be affected. Approximately 26 percent of its employees retiring in 1984 through 1988 would be affected, and, of those retiring in 1989 through 1993, over 60 percent would be affected. Another employer has estimated that the benefits of 3 percent of its 50,000 employees would be limited in two years, 8 percent in eight years, and 22 percent in eleven years

Appendix II demonstrates that an employee earning as little as $35,000 could be affected immediately.[2] The combination of plans described in the appendix is hypothetical, but most ERIC members maintain more than one plan, and neither the benefit levels nor the combination of plans described is atypical. If the employee in the example were age 53 today and planned to retire in 1984, he would either accrue no additional benefit under the defined benefit plan for his last two years of employment or would have to forego some contributions to the defined contribution plans in those years. Thus, he would be affected immediately, regardless of his current age.

Two other employers have estimated that benefits of over 80 percent of their current employees, including many earning less than $24,000, would be limited immediately if the proposals were adopted.

Similar effects would result from adoption of only the proposed limit on defined benefits. One actuarial study applied the proposed limit to the participant populations of ten companies with 9,000 or more employees and conclude that 30 percent to 45 percent of the employees could be affected before reaching retirement age, even though the employee's current average age is 40 and their current average earnings are $25,000. Another study concluded that a 25 year old entering employment at $13,000 would eventually be affected by the proposed defined benefit limit.

C. The Proposals Would Erode Employees' Retirement Security.—A major ERISA objective was to require current funding of pensions to assure that benefits would be paid when employees reach retirement age 20, 30, or more years in the future. The proposed limits would preclude full funding of the accrued benefits of many employees.

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[1] The actuarial assumptions to be used to reduce the $90,000 limit on defined benefits payable before age 65 are critical factors in any such analysis. Under the bill, the Treasury would prescribe the assumptions in regulations. In 1972, the Treasury proposed regulations which contained tables to convert annuities payable at other ages to the equivalent annuity at age 65. Prop. Reg. section 1.402(a)-2(e)(4)(iv)(*b*), 37 Fed. Reg. 9295 (May 6, 1972). Under those tables, a $31,100 annuity payable at age 55 would be the equivalent of a $90,000 annuity at age 65. Under similar authority, the Pension Benefit Guarantee Corporation (PBGC) has prescribed assumptions which must be used to determine whether a terminated plan's assets are sufficient to pay accrued benefits. If the May, 1982, PBGC assumptions were adopted by Treasury, the maximum benefit at age 55 would be only $26,100.

[2] A recent survey of ten large corporations found that the average compensation was about $25,000. Assuming 7 percent annual salary increases (a relatively common assumption for plan funding), the average compensation would be over $30,600 in three years and over $35,000 in five years.

ERISA permits the use of unfunded, unqualified "excess benefit" plans for employees affected by the limits. Appendix I demonstrates that such an "excess benefit" plan could become the primary source of retirement benefits within 15 years. If that employer elected to cover all of its employees under such a plan, nearly 20 percent of the benefit payments to persons retiring between 1983 and 1988 would be made from the "excess benefit" plan, over 37 percent for those retiring between 1989 and 1993, and nearly 55 percent for those retiring between 1994 and 1998.

Present "excess benefit" plans generally cover only a very few highly compensated employees, and it is doubtful that many employers would use such plans to replace all benefits which would be denied by the proposed limits. Furthermore, coverage of large numbers of employees, particularly the rank and file, under such "excess benefit" plans is contrary to ERISA principles. By definition, these plans can not be funded, and employees would be dependent upon an employer's naked promise and continued solvency to collect their benefits. Thus, employees covered by an "excess benefit" plan would be unsecured creditors of the employer. Furthermore, benefits provided by such plans would not be insured by the PBGC.

D. The Proposal Would Occasion Benefit Reductions and Plan Terminations.—Rather than providing major portions of their employee benefits through unfunded "excess benefit" plans, many employers would reduce current benefit levels. Indeed, in light of increasing costs and the current economic pressures on many employers, the review of current benefit formulae in order to comply with the proposed limits could result in terminations of many existing plans. There is no question that this occurred when employers wrestled to implement ERISA, and many feel that the same result would occur if the proposals were adopted, particularly among smaller and marginal employers.

The proposed elimination of the "1.4 rule" would be particularly troublesome.[3] Congress has encouraged the development of employee stock ownership plans, cash or deferred arrangements, and "cafeteria" arrangements. These types of plans benefit rank and file employees and frequently provide the most significant benefits for relatively short-service employees, such as women whose employment is interrupted during child-bearing years. These plans would be sharply curtailed or eliminated if the proposals were adopted. Employers would not continue existing plans if the participation of many employees, particularly the highly paid, were restricted. Certainly, few employers who do not currently have such plans would adopt them.

E. Implementing the Proposals Would Increase Administrative Costs.—All plans would have to be reviewed, and many would have to be amended to incorporate the new provisions. In all cases, summary plan descriptions provided to participants would also have to be amended.

Systems for monitoring benefits for employees affected by current limits are generally simple because relatively few are affected. As shown by Appendix I. the proposals would significantly increase the number of employees whose benefits would have to be monitored.[4] Some employers might have to monitor half or more of their employees immediately, and the number would increase each year. This significant increase in the number of employees potentially affected by the proposed limits would require more sophisticated and expensive monitoring systems.

F. The Proposals Would Affect Collectively Bargained Agreements.—Benefit levels, full benefits at early retirement, employee stock ownership plans, savings plan arrangements, and "cafeteria" plans are frequently collective bargaining issues. Many collectively bargained agreements would have to be renegotiated in order to comply with the proposals.

Consider, for example, the effect on two employees hired on the same day, one at age 20 and the other at age 35, and covered by a union-negotiated "30 and out" plan (full benefits after thirty years of service, regardless of age). Assume the indentical employment and earnings histories. The older employee would probably rerceive a full pension, but the younger could find his pension reduced.[5] Unions would not tolerate this situation.

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[3] The proposed change in the method of computing the defined contribution fraction for the "1.4 rule" is also ill-conceived. ERISA established a cumulative fraction to avoid certain inequitable and absurd results which the proposal would introduce. For example, under the proposal, and employee's pension from a defined benefit plan, accrued and funded over many years, could be significantly reduced or even eliminated by a single large profit-sharing contribution in the year of his retirement.

[4] All employees who are potentially affected would have to be monitored even if many did not participate to the fullest extent allowed in defined contribution plans.

[5] Using current PBGC actuarial assumptions, the maximum benefit payable at age 50 would be $14,800. A plan benefit of 50 percent of final pay would exceed the limit for anyone earning $30,000 or more. This adverse effect would occur at lower earnings if the employee participated in any savings, employee stock ownership, or other defined contribution plan.

G. Periodic Adjustments Are No Substitue for a Formula Which Keeps Pace with Inflation.—It has been suggested that Congress would periodically adjust the proposed dollar limits to reflect inflation. This is no substitute for a COLA. Rarely has Congress addressed or adjusted a specific limit once it has been placed in the Code, and it is not reasonable to expect that Congress would address this issue every few years. Even if the limits were reviewed and increased "after the fact", there would be considerable "backloading" and significant unfunded past service liabilities as benefit levels "caught up" to the new limits.[6] This "backloading" and unfunded liability would be inconsistent with the complex ERISA requirements that plans accrue and fund benefits ratably over an employee's career.

H. The Proposals Would Significantly Reduce Long-Term Savings and Investment Capital Necessary to the Nation's Economic Recovery.— ERTA provided significant incentives to encourage savings and increased capital investment. The proposals run counter to these policies.

Private plan contributions are a major source of investment capital. By decreasing current funding, there would be a direct decrease in investment capital. This seems particularly inappropriate today.

II. RESTRICTIONS ON LOANS TO "KEY EMPLOYEES" AND PARTICIPANTS IN CASH OR DEFERRED ARRANGEMENTS

H.R. 6410 would restrict loans from qualified plans to certain "key employees". The amount received as a loan or pledged as security for a loan by a "key employee" would be treated as a plan distribution. "Key employees" would include, in addition to officers and 5 percent shareholders, the highest paid 15 percent of employees and any employee who deferred an amount under a qualified cash or deferred arrangement.

ERIC opposes the proposal. It is overly broad, would create significant administrative burdens, would discourage participation in contributory plans by rank and file employees, and would reduce the private savings incentives embodied in ERTA.

A. Loans from Qualified Plans Are Subject to Significant Restrictions Under Current Law.—ERISA and the Code permit loans from qualified plans only if they bear a reasonable rate of interest, are adequately secured, provide a reasonable repayment schedule, and are made on a nondiscriminatory basis, both with respect to general availability and amount.

The Service and the Department of Labor have the authority to prevent any abusive of sham loans. For example, in Rev. Rul. 81-126, 1981-1 C.B. 206, the Service treated certain "loans" received by an employee before the annuity starting date as plan distributions. Similarly, in Rev. Rul. 82-94, 1982-20 I.R.B. 5, the Service disregarded and artifically created loan from a child to his parents from funds provided by the parents.

Loan programs are attractive, efficient investments for qualified plans which benefit all employees by earning a market rate of interest and providing them with a source of funds to meet unanticipated expenses. Many lower paid employees find temporary loans from savings and thrift plans important in financing their homes, their children's educations, and medical and other unanticipated expenses. Most plans have provisions for so-called "hardship" distributions, which could be used for such purposes, but loans are more efficient and less costly to employees. They are often simpler and more convenient to obtain than loans from other sources, and repayments can be simplified through payroll deductions. In addtion, the proceeds of a repaid loan are available at retirement, but a "hardship" distribution in lieu of a loan is not. Thus, loans further the purpose of encouraging savings for retirement.

B. Administrative Costs Associated with the Proposal Would Cause Employers to Restrict Loans for All Employees.—The proposal would significantly increase the cost of administering any loan program. In many large companies, the 15 percent highest paid employees would include several thousand employees, most of whom are not "key" members of management and whose compensation would normally not be considered high.

New monitoring, accounting, and record keeping systems would have to be developed to determine the employees who would be treated as "key employees" in any year. An employee would be considered one of the highest paid 15 percent either if his current compensation in the year of the loan would place him within that group or if he was within that group in the calendar year immediately preceding the year of the loan. A determination would be required, at the time of the loan, whether the employee might be a "key employee". This would be unwarranted administrative burden, particularly when payroll records are maintained in many widely scattered locations.

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[6] The PBGC guarantees payment of certain unfunded benefits when a defined benefit plan terminates. Its limited resources could be further strained by unfunded liabilities resulting from irregular increases in the limits.

These increased administrative costs would be a disincentive to establish or maintain a loan program, and many programs would be terminated to the detriment of all employees.

C. Loan Restrictions Would Affect Rank and File Participation in Cash or Deferred Arrangements and Other Plans.—Many younger employees are naturally reluctant to set aside funds for 30 or 40 years until retirement. Thus, the restriction or elimination of loan provisions would discourage participation by the rank and file in many profit-sharing, savings, thrift, cash or deferred, and similar arrangements. The failure of significant numbers to participate could cause existing arrangements to be disqualified as discriminatory. This would not be in the best interest of any employee.

ERIC is particularly concerned with the potential effects on cash or deferred arrangements. The hardship withdrawal rules proposed last November (46 Fed. Reg. 55544 (Nov. 10, 1981)) are significantly stricter than the existing rules for profit-sharing and savings plans. If those proposed regulations were adopted and loans were not permitted, many are concerned that few lower paid employees would elect to participate and that discrimination issues would be raised. The Service has previously attempted to discourage the use of such programs, but Congress, in 1974, overrode the Service's restrictions and, in 1978, provided detailed standards for such plans. The current proposal would again discourage employers from adopting such plans and effectively reverse the incentives provided in the 1978 legislation.

III. INTEGRATION OF PRIVATE PENSION PLANS WITH SOCIAL SECURITY

H.R. 6410 proposes to revamp entirely the current integration rules which coordinate benefits provided by private plans with Social Security. The Social Security system is currently under significant stress. While the present integration rules may not be perfect, ERIC strongly opposes any change until the bipartisan National Commission on Social Security completes its study this December and until there is adequate opportunity to consider its proposals.

Both as a policy matter and in its technical application, integration is complex. Far from being a "simple" solution, the proposal would be costly and difficult to administer. It would require amendments to all currently integrated plans, and benefits for many low-paid employees would be reduced.

A. Integration Is an Essential Element of a Sound National Retirement Policy.—The use of integration in determining pension benefits has been permitted by the Code since 1942. Integration is the method by which a particular employer coordinates a privately administered pension plan with the Social Security system to achieve an appropriate retirement income which does not discriminate in favor of officers, shareholders, or the highly compensated.

Integration of Social Security with private pension plans is a key element in the fulfillment of national retirement income goals. The objective of both private plans and Social Security is identical: to achieve an adequate retirement income. Social Security, through its limited covered wage base and benefits, is "weighted" in favor of lower income employees. Integration by private pension programs is an attempt to provide for all employees a reasonable level of retirement income.

B. Recommendations of the National Commission on Social Security Reform May Affect Integration.—Generally, the current integration rules work reasonably well in fulfilling these national retirement goals. There is no question that the current rules are highly complex, may arguably rest on a questionable foundation, may be outdated, and, particularly in view of the ever-increasing Social Security wage base and benefits, may be in need of significant revision. ERIC is not arguing that integration should be continued in its present form indefinitely. However, the system has been in place since 1971 and any change in the system would result in costly amendments to pension plans.

The President has appointed a bipartisan National Commission on Social Security Reform which is scheduled to complete its study of the Social Security system this December. It is quite possible that the Commission may recommend major revisions in the Social Security system.

Changes in integration rules made now might be incompatible with future changes in the Social Security system. Successive changes in integration rules would not be in the best interests of plans or participants. Accordingly, ERIC strongly urges that any amendment to the current integration rules should be deferred until the Commission has issued its final report and until the issues have been carefully and thoroughly examined.

C. The Proposal Is Not Simple or Rational and Would Discriminate Against Younger, Short-Service Workers.—Integration based on the taxes actually paid in any given year would not bear any rational relationship to the benefit which the employee would eventually receive from Social Security. It is not a "purchase" system. Benefit levels are set independently of the contribution levels, and, as is becoming more apparent, current Social Security taxes are supporting current benefits, not the future benefits accrued for any particular employee.

Similarly, while the statement of the proposed rule may be simple, its application would be difficult. The current integration rules are also relatively straightforward. Complexity arises not from the statement of an integration rule, but from the detail necessary to apply any such rule to various types of plans and benefit formulae. In practice, the current integration rules appear to be simpler than the proposal.

For example, if an employee is employed from ages 25 to 35, the annuity value of the employer contributions would be much greater than the annuity value of the same contributions made on behalf of an employee employed from ages 55 to 65. The proposal would allow greater offsets than those now taken for younger, short-service employees as a result of the interest factor applied to employer contributions. Many are concerned that the offsets permitted for young, short-service employees may exceed their accrued benefits. The effects would disproportionately fall on minorities and especially on women whose employment may be interrupted during childbearing years. From an administrative standpoint, it would require individual records of the taxes paid for each employee. This would not be simple; it would not be rational; it would be expensive.

Administrative burdens would be exacerbated by treating benefits of employees hired prior to 1984 differently than the benefits of those employed thereafter. The former would be governed by the current integration schedules, but the latter would be under the new rules.

Furthermore, employees' understanding of their pension benefits would be diminished. It would be very difficult for an employer to explain how the proposed integration would work or to develop any reasonable table from which an employee could estimate his benefits. Under many current integration formulae, even if the basis for integration is not completely understood, an employee can be given a relatively simple formula which he can use to figure his benefit with some degree of certainty.

D. Current Integration Formulae Generally Provide Limited Offsets Related to the Employee's Years of Service for the Employer.—Congressman Rangel has focused on the present rules which permit a maximum offset of up to 83⅓ percent of an employee's primary insurance amount ("PIA") or, if a "step-rate" method is used, may exclude those under the Social Security wage base from receiving any plan benefits. ERIC members maintain very few, if any, so-called "pure excess" plans which provide no benefits to the lower paid. The plans maintained by ERIC members generally provide benefits in addition to Social Security for all retirees. Indeed, studies indicate that most plans do not use the maximum integration levels or percentages.[7] Thus, while some plans probably exclude the lower paid employees through integration, the practice is not widespread.

In 1978, ERIC members were surveyed with respect to their defined benefit plans integration formulae. The typical formula provided a benefit which was a percentage of final average pay times years of service offset by the same percentage of the employee's PIA. The percentages used by ERIC members in the formulae ranged between 1.1 percent and 2 percent with the majority being at 1.5 percent or above. In most cases, there is a "cap" of 30 on the number of years of service which can be taken into account in determining the Social Security offset. Thus, if a 1.5 percent formula is used, a 30-year career employee would receive 45 percent of final average pay offset by 45 percent of his PIA. If a 2 percent formula were used, the maximum offset would be 60 percent; however, many such plans have voluntarily "capped" offsets at 50 percent.

These types of formulae satisfy one primary criterion of the bill: an employer using such a formula is already taking into account only the number of years an employee has worked for him in determining the offset amount.

E. The Proposal Would Reduce Benefits for Long-Service, Low-Paid Employees.—Contrary to Congressman Rangel's intent, a preliminary comparison to current, commonly used integration formulae indicates that the proposal would increase offset amounts for long-service, low-paid employees and may be generally detrimental to the rank and file.

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[7] *See* 1981 White House Conference on Aging, *Final Report,* Vol. 1, 60 (June, 1982); President's Commission on Pension Policy, An Interim Report, 43 (November, 1980).

As indicated above, a typical formula for offset integration used by ERIC members would be 1.5 percent of final average pay per year of service offset by 1.5 percent of the employee's PIA per year of service (not to exceed 30 years). Appendix III demonstrates the curent total income replacement ratios provided by this typical formula, the portions currently provided by Social Security, and the plan benefits after integration for ten employees beginning employment in 1983 at vaious ages and salary levels. It also shows what these ratios would be under the proposed rule and the portions which would be provided by Social Security and the Plan.[8]

Appendix III demonstrates that while the proposed rule would marginally increase the benefits of older, short-service, low-paid employees, it would severely discriminate against long-service, low-paid employees. Under the proposed rule, the maximum permitted offset with respect to these employees would be significantly greater than that under a 1.5 percent formual (and, as a consequence, the amount provided by the plan would be less).

Some might criticize this analysis on the basis that it compares an exisiting plan formula which does not take advantage of the maximum integration permitted under current law with the maximum integration permitted under the proposal. However, employers using a typical 1.5 percent formula or higher would not be able to maintain their existing integration fromulae because the offsets would be higher at some levels than the maximum permitted under the proposal. See, for example, the low-paid employee at age 45. Current formulae would have to be amended, and employers would probably adopt the maximum offset allowed under the proposed rule.

F. The Proposal Would Generate Significant and Unnecessary Paperwork Burdens.—A direct result of any change in integration rules would be the necessity to review every plan which is currently integrated. In the absence of many important details, it is impossible to predict how employers would react to the new proposal. It appears clear, however, that most integrated plans would have to be amended. In some cases, renegotiation of collectively bargained agreements would be required.

Once revised benefit formulae were adopted, plans would have to be resubmitted to the Service for amended determination letters. This additional determination would require both employers and the Service to expend significant resources.

Other attendant indirect costs would also be significant. Summary plan descriptions required by ERISA would have to be revised, printed, and provided to all participants. The actuarial bases for funding the plans would have be to be revised. In addition, completely new computer programs would have to be developed to take into account pre- and post-effective date employees and to monitor individually all new employees with respect to integration. Significant time would also be consumed in explaning the new benefit formulae and complex integration rules to participants.

Thus, the proposal would be expensive and disruptive to existing plans. Some plans would be terminated to avoid these costs. In ERIC's view, these costs cannot be justified in light of the proposal's apparent failure to achieve the results intended.

IV. RESTRICTIONS ON DISCRIMINATORY FRINGE BENEFIT PLANS

H.R. 6410 would replace the several nondiscrimination rules for fringe benefit programs with a single rule and would extend that rule to insured medical reimbursement plans. Under the proposal, "key employees", which would include officers, 5 percent shareholders, and the 15 percent most highly compensated, would be required to include in income a share of the employer's costs for benefits provided under any discriminatory plan.

ERIC general supports simplifications of the Code and the adoption of uniform definitions. It also generally prefers treating discriminatory amounts as income, rather than disqualifying the entire program.

Nonetheless, the proposal needs careful study. It would impose severe administrative burdens on fringe benefit programs, and, although the standards are unclear, the proposal would appear to treat many programs as discriminatory, even though they satisfy current standards. The minimal improvements in uniformity should be weighed carefully against the significant burdens imposed to achieve them.

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[8] Under the proposed rule, the Treasury would be required to issue regulations providing actuarial assumptions to be used to convert the employer's Social Security taxes paid for any employee into the an equivalent annuity beginning at age 65. This would be the maximum offset allowable. In the absence of these regulations, no definitive analysis of the proposed rule can be undertaken.

A. The Proposed Nondiscrimination Standard Is Unclear and Does Not Recognize Employee Preferences.—Plans would be considered discriminatory unless "the type and amount of benefits available under the plan do not discriminate in favor of participants who are key employees". The proposal fails to recognize clearly that the the cost of certain benefits fluctuates geographically. For example, the average per day cost of a hospital room in New York is substantially higher than the average per day cost for that same type of room in Mississippi. The equality of benefits should clearly hinge upon the type of the benefit provided rather than upon the amount available to each employee.

Furthermore, different groups of employees legitimately perceived different health and welfare needs. A mine worker, for example, has different health concerns and requirements than an assembly line worker, and both differ from an office worker, particularly an executive. Top executives, after all, tend to be older than assembly line workers who are frequently young, single, and mobile. Similarly, an executive or highly educated technician may value certain coverage for his family that a rank and file assembly line worker may consider a worthless "extra", even if fully paid for by the employer.

Regional differences, market forces, and benefits mandated by the States [9] may also influence or determine the choice of fringe benefits for locations throughout the country. A scientific research facility in California may provide a different package of fringe benefit programs to attract and retain skilled professionals than an assembly line operation in South Carolina, even though both are opereate by the same employer.

B. The Proposal Would Drastically and Adversely Affect Disability Programs.—It has long been recongized that retirement, disability, and life insurance benefits which bear a reasonable relation to compensation are nondiscriminatory. Under the proposal, any benefit based on compensation would be discriminatory. Both long- and short-term disability benefits are wage related to enable a disabled employee to continue his pre-disability standard of living and to replace lost income. This treatment should be continued.

C. Existing Life Insurance Programs Would Have To Be Revised.—Under existing rules, life insurance provided by employers must be available on a nondiscriminatory basis, but employers may provide different amounts to employees based on their compensation. We are concerned that programs which currently satisfy these rules would be considered discriminatory under the proposal.

Clearly, life insurance benefits which are related to compensation would not satisfy the general "equal benefits" rule. The proposal contains a special rule that a group life insurance progam would not be considered discriminatory "merely because the amount of life insurance on behalf of the employees . . . bears a uniform relationship to total compensation." Most existing life insurance programs would not satisfy this standard.

For convenience of administration, existing rules permit employees to be "bracketed" by compensation ranges. By requiring a "uniform relationship", the proposal does not appear to allow bracketing. Under many programs, the amount of life insurance currently offered is in "round number" increments, such as $1,000, $5,000, or $10,000. In combination with bracketing, this eases administration. For example, employees earning less than $15,000 might be offered $15,000 of coverage, those earning over $15,000 but less than $20,000 might be offered $20,000 of coverage, and so on. Under a uniform relationship rule, different amounts of insurance might have to be offered to an employee earning $16,500 and an employee earning $17,000. this change appears unnecessary.

In addition, under the uniform relationship proposal, higher paid participants might have to take amounts into income even though the program favors the lower paid. Because of the current $50,000 limit on tax-free, employer-provided life insurance, some programs may now be structured so that a higher option in relation to compensation is provided for the lower paid than to the higher paid. Any such program would appear to fail both the proposed uniform relationship and the proposed equal benefits rules. Obviously, however, such a program is not discriminatory in favor of the highly paid and should not result in their recognizing income.

D. The Proposed Allocation of Costs Among Key Employees Would Be Unfair and Would Present Serious Compliance Problems.—The proposal presents serious definitional and compliance problems. It essentially provides that the portion of the employer's cost of a discriminatory plan which is attributable to the benefits provided to key employees is to be prorated among key employees and is to be included in their taxable incomes.

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[9] *See*, for example, *Wadsworth* v. *Whaland*, 562 F.2d 70 (1st Cir. 1977), *cert. denied*, 435 U.S. 980 (1978).

This rule would require a key employee to take into account the cost of all benefits which are provided to him under the plan, not just the portion attributable to the benefit which is discriminatory. At most, a key employee should be taxed only on the amount which he receives in excess of amounts provided to the rank and file. Any other result would be punitive. A particular plan might provide a wide variety of benefits to all employees, and only an insignificant portion of the total costs might be attributable to discriminatory benefits.

In addition, there would be difficulties in calculating the employer's cost. Would it be an amount equal to the *per capita* costs for all employees or would it have to be "weighted"? In many cases, it would be impossible to determine within a reasonable period after the plan year the cost of benefits which must be included in income. For example, under the various types of experience-rated insurance contracts, the actual cost of the plan would not be known until well after January 31, precluding the employer from including any amount on key employees' W-2 Forms.

As indicated above, ERIC is also troubled by the inclusion of the highest paid 15 percent of employees within the prohibited group. In large business entities, this would encompass several thousand employees who would not be "key" management personnel and whose compensation would not normally be considered high. It is doubtful that benefits would discriminate in their favor, but the proposal would appear to require that they recognize income even if the plan discriminated only in favor of top management. This would be difficult to explain and to enforce.

V. EXTENSION OF RULES FOR SELF-EMPLOYED INDIVIDUALS TO PERSONAL SERVICE CORPORATIONS

H.R. 6410 would extend rules presently applicable to plans maintained by self-employed individuals, including owner-employee restrictions, to plans maintained by certain "personal service corporations". Any employee who owned as little as one share of its employer's stock, however acquired, would be treated as a self-employed individual.

ERIC opposes the proposal. It would create an arbitrary distinction which would be difficult to administer and, despite the fact that they are large corporations, may directly affect some ERIC members. Plans would be amended or discontinued to avoid potential disqualification, significantly weakening the private sector and directly affecting rank and file employees.

A. The Proposal Would Arbitrarily Discriminate Against Certain Professions.—Rather than limiting the existing distinctions between owner-employees and corporations with respect to employee benefit plans, the proposal would create an additional distinction based on the type of business conducted. It arbitrarily signles out for special adverse treatment corporations engaged in the fields of health, law, engineering, architecture, accounting, actuarial science, the performing arts, athletics, and consulting. Other personal service corporations, such as real estate agents, would be unaffected.

Although they are generally large, publicly-held corporations, some ERIC members have subsidiaries whose principal business may be in one of the designated fields. For example, a major manufacturer may have an engineering subsidiary. In that situation, it appears that the bill might require that different plans be maintained for employees in that subsidiary. Perversely, the plans maintained by the subsidiary might become the model for all plans of the corporate group, because existing law treats all employees of a controlled group of corporations as employees of a single employer. These results can not have been intended, but it is unclear how they would be avoided.

No justification exists for imposing additional restrictions upon any specific service corporation. They are corporate entities with employees whose retirement needs are no less than those of other corporate employees, particularly when they all are members of the same controlled group.

B. Rank and File Employees Would Be Directly Affected.—The proposal would affect any employee who owned stock in the corporation. Rank and file employees with as little as one share of their employer's stock would be treated as self-employed individuals. Not only would their benefits be significantly restricted, but benefits provided by any plan in which they participate would also have to be reduced to the self-employed limits, affecting all rank and file participants. Furthermore, if an employee who participated in a corporate plan were deemed to own 10 percent of the stock of the personal service corporation, the plan would be disqualified.

This would be especially troublesome in corporations which maintain profit-sharing or employee stock ownership plans through which rank and file employees own corporate securities. Thus, the proposal could curtail the use of such plans by corporations in the designated service industries to the detriment of their employees.

C. The Proposal Presents Difficult and Costly Administrative Issues.—The proposal involves complex and arbitrary distinction which would be difficult and expensive to administer both for employers and the Service. The determination of a corporation's "principal business" often would not be simple. Would it be determined by income from or assets used in or number of employees engaged in each of several lines of business? Could it change from year to year? The Service would be faced with numerous "close" situations, and employers could be expected to seek judicial review of adverse determinations. Such a process would be expensive and would inevitably result in arbitrary "line-drawing" and unwarranted distinctions between employee benefit programs of competing employers.

If a personal service corporation attempted to maintain an ordinary corporate plan, its enforcement burden would be significant. It would have to survey all employees to determine if they owned stock. It would have to restrict employees from purchasing its stock, even in the open market. Because of attribution rules, these restrictions would be applicable to employees' families and other close relatives. Enforcement of any such restrictions would be difficult or impossible, but the failure of even one employee to comply could potentially disqualify the plan.

Respectfully submitted.

MAYER, BROWN & PLATT,
JERRY L. OPPENHEIMER.
ROBERT H. SWART.

Appendix I

Effect of Proposed Limits on Contributions and Benefits on Employee Population of One Large Employer

Plans:

Defined Benefit:

1.6% of Final Average Earnings times years of service reduced by 1.5% of PIA times years of service (not to exceed 33-1/3 years).

Retirement with full benefits at age 62.

Defined Contribution:

Employee contributions up to 6% of salary are fully matched by employer. Additional employee contributions of up to 3% are permitted.

Assumptions:

Benefit levels discounted to age 62 using actuarial assumptions contained in proposed regulation section 1.402(a)-2(e)(4)(iv)(b), 37 Fed. Reg. 9295 (May 6, 1972).

The actual average retirement age for this employer is 58. However, for purposes of this table, it has been assumed that all retirements are at age 62.

Limits satisfied solely by limiting benefits from defined benefit plan; maximum participation in defined contribution plans throughout period.

8% annual salary increases.

Period Within Which Employee Will Retire	Number of Employees Retiring Within Period	Number Affected	Percentage Affected	Percentage of Accrued Benefits Which Can Not Be Paid from Qualified Plan
1983	371	47	12.66%	7.70%
1984 - 1988	4,639	1,212	26.13%	19.70%
1989 - 1993	4,444	2,697	60.69%	37.15%
1994 - 1998	3,375	3,018	89.42%	54.70%
1999 - 2003	3,721	3,593	96.56%	64.00%
2004 - 2024	15,460	15,460	100.00%	82.00%
Total for Period 1983 - 2024	32,010	26,027	81.31%	71.00%

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Appendix II

Effect of Proposed Limits on Contributions and Benefits on Employee Earning $35,000 in 1983

Plans

Defined Benefit:

2% of Final Average Earnings times years of service reduced by 2% of PIA* payable at age 55 with 30 years of service.

Cash or Deferred Profit Sharing:

6% "elective" salary reduction.

50% employer "match" (maximum 3% of salary).

Employee Stock Ownership Plan (ESOP):

Varying employer contributions; assumed at 1% of salary.

Assumptions:

Employee earning $35,000 in 1983.

30 years of service at age 55.

Defined Benefit Fraction:

[(.02 × 30 yrs.) × $35,000] less [(.02 × 30 yrs.) × $8,515 (1983 maximum PIA)] = $15,891 (projected benefit)

(Note: current salary used with no assumptions for salary increases due to raises or inflation)

$15,890/$26,100 = 0.61

(Note: $26,100 is $90,000 discounted to age 55 using PBGC actuarial assumptions)

Defined Contribution Fraction:

6% (elective contribution) + 3% (employer "match") + 1% (ESOP contribution) = 10%

10% × $35,000 = $3,500

$3,500/25% of $35,000 = 0.40

Combined Fraction:

.61 +.40 = 1.01 (exceeds proposed limit)

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*Even if the integration proposals were adopted, current employees would remain subject to existing integration formula.

Appendix III

Comparison of the Replacement of Final Earnings by Total Retirement Income Under the Proposed Offset Integration Method and a Current Typical Integration Formula

Plan:

1.5% of Final Earnings times years of service (maximum 30 years) under both rules.

Under the 1.5% of formula, offset is 1.5% of PIA times years of service (maximum 30 years).

Under the proposed rule, offset is the annuity equivalent of OASDI tax amount projected to age 65 at 8% interest and then converted to monthly straight life benefit at 5% interest and 1971 Group Annuity Mortality.

Assumptions:

100% work force participation from ages 25 to 65 for the determination of PIA amount.

6% annual salary increases.

		1.5% Formula			Proposed Rule			
			Part Provided by			Part Provided by		
1983 Entry Age	1983 Salary	Total Replacement Ratio	Social Security	Plan	Total Replacement Ratio	Social Security	Plan	Increase or Decrease in Replacement Ratio
25	10,000	68%	42%	26%	53%	42%	11%	-15%
	20,000	62%	31%	31%	42%	31%	11%	-20%
35	15,000	66%	39%	27%	61%	39%	22%	-5%
	30,000	59%	25%	34%	48%	25%	23%	-11%
45	10,000	62%	46%	16%	63%	46%	17%	+1%
	20,000	54%	34%	20%	50%	34%	16%	-4%
	40,000	43%	19%	24%	39%	19%	20%	-4%
55	10,000	57%	50%	7%	59%	50%	9%	+2%
	25,000	37%	26%	11%	35%	26%	9%	-2%
	50,000	28%	16%	12%	27%	16%	11%	-1%

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL, NATIONAL RETIRED TEACHERS ASSOCIATION AND AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. **Hacking**. I am the assistant legislative counsel for the American Association of Retired Persons. NRTA has now been merged into AARP. We have a membership well in excess of 3,300,000 persons age 55 and older. I would like to file the association's statement for the record, and summarize.

Mr. **Rangel**. Without objection.

Mr. **Hacking**. We consider H.R. 6410 to be major legislation which could result in a significant restructuring of the private pension system. It therefore merits very careful review and assessment.

Generally speaking, ARP strongly supports the legislation's goal of providing equitable pensions to the greatest number of persons in the work force. The association believes that there are serious shortcomings in the current system of delivering private pension benefits. For example, current integration rules can deny a lower paid worker a pension benefit, even though his social security benefit does not by itself constitute anywhere near an adequate level of retirement income.

Under the present system some prosper, others do not. The challenge before the committee is how to encourage greater equity without causing employers to choose not to offer pension to their employees.

Obviously a balance has to be struck. Because H.R. 6410 was introduced only very recently, we think there is a great deal of work that has to be done in terms of assessing the probable effects resulting from the implementation of the changes this bill contemplates.

I would like to offer some brief comments to some of the major elements of this legislation. Section 2 of H.R.6410 reduces the maximum amount which can be contributed to a qualified pension plan. Additionally, the provision of current law which adjusts these figures to changes in the CPI would be repealed.

The association supports the efforts to limit the tax expenditures for pension savings to amounts needed to fund realistic and reasonable benefit levels. However, we are concerned that the proposal could have unintended effects, particularly in the case of defined benefit plans.

While a $90,000 pension today is a very sizeable amount, it may not be in 30 years when a currently 35-year-old worker retires. Fixing the maximum amount could introduce unfortunate rigidity into the system and that could be detrimental to pension planning. Similarly the legislation's attempt to restrict the maximum deduction in cases in which the employer has a defined benefit and contribution plan warrants careful review to determine if any unintended effects would result.

In cases in which retirement under a defined benefit plan would occur before 65, H.R. 6410 would require an actuarial reduction of the benefit amount. This is not mandated now unless the worker retires before age 55. We believe that people should be encouraged to stay in the labor market as long as possible, but we feel an actuarial reduction because of retirement before age 65 should be complemented by an actuarial increase in the case of people who work past their plan's normal retirement date.

Section 4 would alter the present standards for integrating private pensions with social security. As a practical matter the association is aware of instances in which integration rules have eliminated or nearly eliminated lower paid workers from defined benefit plans. Workers in defined contribution plans do not necessarily fare much better—integration rules could leave them with little or no pension.

In light of our experience, the association is pleased that this legislation at least attempts to address the integration problem. Changes in integration rules need to be made to assure that employees will end up benefiting from their employer's pension plan, and more so than would otherwise be the case under present rules.

However, a clear assessment of the impact of the changes 6410 would make must be made before we could determine whether the solution offered is indeed the best approach to take.

In our full statement, we have outlined what we believe the positive features of this integration approach are.

In summary, the association believes that 6410 is a helpful effort to correct the fact that private pension benefits are not distributed equitably and that part of the large tax expenditure designed to encourage plan formation may be unnecessarily generous.

However, due to the extremely complicated nature of the provisions of the bill and the short time available to analyze them, it is difficult to conclude that they are clearly in the best interest of workers and retirees.

We would like to continue to work with the committee as the impact assessment we think is necessary is undertaken, and the provisions are further refined.

Thank you, Mr. Chairman.

Mr. RANGEL. Thank you.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

I. OVERVIEW

The National Retired Teachers Association and the American Association of Retired Persons appreciate the opportunity to testify on H.R. 6410, the Pension Equity Tax Act of 1982. The Associations feel that H.R. 6410 is a major piece of legislation, which could result in a significant restructuring of the private pension system. Because of its importance, this legislation merits careful review.

Perhaps the most compelling reason for Congress to look at whether private pensions are distributed efficiently is the level of federal involvement in the pension area through tax expenditures. According to a recent Senate Budget Committee report, the revenue loss for private pension incentives is expected to be nearly $26 billion in fiscal year 1982. While providing incentives for retirement savings is a worthy goal, which the Associations strongly support, this effort must benefit as wide a population as possible. This is particularly important as more people come to realize they cannot live on social security alone.

Our associations have found, through an analysis of the relevant tax laws and through contact with our membership that there are shortcomings in the current system of delivering private pension benefits. For example, current integration rules can deny a lower paid worker a private pension even though his or social security benefit does not, by itself, constitute an adequate retirement income. Under the resulting system, some people prosper and others do not. The challenge before the

Committee and before parties interested in pension reform is to encourage greater equity without making the price so high that employers choose not to offer pensions to their employees.

The Associations appreciate Congressman Rangel's efforts to resolve some of these problems by sponsoring H.R. 6410. Because the legislation was introduced very recently, there is a good deal of information about its impact that needs to be made available. While H.R. 6410 gets into a number of very complicated areas, we can offer some comments regarding the direction this legislation takes.

II. LOWER CONTRIBUTION AND BENEFIT LIMITS FOR TAX-SUBSIDIZED ANNUITIES

Section 2 of H.R. 6410 reduces the maximum amount which can be contributed to a qualified pension plan. For a defined contribution plan, the maximum annual contribution is lowered from over $45,000 to $30,000. In the case of a defined benefit plan, the maximum contribution which can presently fund an annual benefit of over $136,000 is lowered to an amount that can fund an annual benefit of $90,000. Additionally, the provision of current law which adjusts these figures to changes in the consumer price index would be repealed.

The Associations support Congressman Rangel's effort to limit the tax expenditure for pension savings to amounts needed to fund realistic benefit amounts. However, we are concerned that the proposal could have unintended impacts, particularly in the case of defined benefit plans. While a $90,000 pension today is a sizeable amount, it may not be in 30 years, when a 35-year-old worker retires. Fixing the maximum amount could introduce a rigidity into the system, which would be detrimental to pension planning. Similarly, the legislation's attempt to restrict the maxiumum deduction in cases in which the employer has a defined benefit and a defined contribution plan warrants careful review to determine if any unintended effects (i.e., termination of one of the plans) would result.

In cases in which retirement in a defined benefit plan occurs before age 65, H.R. 6410 would require an actuarial reduction in the maximum benefit. Under current law, the decrease is not mandated unless a person retires prior to age 55. While the Associations share the sponsor's concerns that workers be encouraged to remain in the labor market, we believe this could also be accomplished through an incentive approach. It is our understanding that current Section 415 regulations (26 CFR Sec. 1.415-3) prohibit many actuarial increases for workers who stay on beyond their plan's normal retirement age. This practice should be overturned so people can receive incentives to continue working.

Section 2 of H.R. 6410 also would include post-retirement medical benefits as part of the compensation package for Section 415 purposes. We see no reason for having this provision in the legislation. Its existence creates the risk that the plan will choose not to offer these medical benefits.

III. INTEGRATION WITH SOCIAL SECURITY

Section 4 of H.R. 6410 would alter the present standards for integrating private pensions with social security. Under current law, social security benefits are taken into account in determining whether the pension plan discriminates in favor of highly paid workers. As a practical matter, the Associations have seen cases in which integration rules have eliminated or nearly eliminated lower paid workers from defined benefit plans. Workers in defined contribution plans do not necessarily fare much better—integration rules could leave them with little or no pension.

In light of our experience, the Associations are pleased that Congressman Rangel has addressed the integration problem. Changes in integration rules need to be made for all employees to benefit from their employers' pension plans. However, until the impact of changes H.R. 6410 would make are clear, it is difficult to determine whether the solution offered is the best approach to take.

Positive features of the integration section of H.R. 6410 are: (1) lower paid workers would be more likely to participate in defined contribution plans, (2) they would be less likely to be integrated entirely out of their defined benefit plan, and (3) shorter service workers would be less likely to be integrated out of their defined benefit plan.

Questions that remain regarding this approach include: (1) is it likely that some people would end up receiving greater than 100 percent of their final average pay (including social security) if they retire and would this be sound retirement policy, and (2) would any inequities result from this integration formula?

Perhaps an evaluation of these questions could lead to the conclusion that some recognition of the present social security benefit structure is necessary in designing private pension plans. However. the consideration must not produce the harsh results that can, at times, be produced by the current system.

IV. EXTENSION OF RULES APPLICABLE TO PLANS FOR SELF-EMPLOYED INDIVIDUALS TO PLANS OF PERSONAL SERVICE CORPORATIONS

Section 6 would extend participation, vesting and assorted other Keogh rules to plans of personal service corporations. This section could help employees of personal service corporations who are much less likely to work at the corporation for a long period of time than are the corporation's principals.

V. CONCLUSION

H.R. 6410 is a helpful effort to correct the fact that private pension benefits are not distributed equitably and that part of the large tax expenditure designed to encourage plan formation may be unnecessarily generous. The Associations support the careful review of these problems and some of the recommended solutions contained in H.R. 6410. We believe that other provisions of the legislation head in the right direction. However, due to the extremely complicated nature of these provisions and the short time available to analyze the bill, it is difficult to conclude that they are clearly in the best interest of workers and retirees. The Associations would like to continue to work with the Committee as the needed information is developed.

Mr. RANGEL. Mr. Holan.

STATEMENT OF WALTER HOLAN, PRESIDENT, PROFIT SHARING COUNCIL OF AMERICA, ACCOMPANIED BY LARRY E. SHAPIRO, COUNSEL

Mr. HOLAN. I am president of the Profit Sharing Council, accompanied by Larry Shapiro, attorney for the council. The council is a nonprofit association of approximately 1,400 employers who have profit-sharing plans. These plans cover about 1,750,000 employees. Council members are located throughout the United States and are engaged in practically all areas of economic activity. Many companies range in size from Fortune top 200-size companies down to the ma-and-pa family operation.

The council defines profit sharing as any procedure under which an employer pays or makes available to employees subject to reasonable eligibility rules, in addition to prevailing rates of pay, current or deferred sums based on the profits of the business. Under deferred profit-sharing plans, the employer contributions are allocated to an employee's account, together with the employee's own contributions, if any, and those sums are then invested for the benefit of the employee and subject to investment risk.

At retirement all of the company contributions, the employee contributions, the gains or losses, and the reinvested earnings are made available to the employee for his retirement benefit. The council estimates there are approximately 17 million employee participants in about 315,000 deferred profit-sharing plans. Employee profit-sharing trusts now hold over $75 billion in invested assets on behalf of these participants.

The council and its member companies actively participated in hearings during the development of the Employee Retirement Income Security Act of 1974. Since ERISA, the council and its members have likewise taken the opportunity to work with the Internal Revenue Service and the Department of Labor in developing regulations promoting the orderly administration and regulation of tax-qualified profit-sharing plans.

Today, almost 8 years after its enactment complete final regulations under all sections of ERISA have not yet been issued. A joint task force of IRS, Treasury, and Labor Department officials continues to review its operation. A special Presidential Commission of experts in the area has met and offered its recommendations.

The council is opposed to the enactment of H.R. 6410 because of the far-reaching ramifications it would have on qualified profit-sharing plans and the private retirement sector generally. If enacted as proposed, it would inhibit the creation of new profit-sharing plans and jeopardize the continuing existence of those plans already qualified under section 401(a) of the Code.

We are particularly concerned because these changes would come at a time when public confidence in the social security system is at an alltime low. Now, more than ever, the private sector should be given every opportunity to expand and take up the slack in providing retirement savings.

The council agrees that the broadest possible class of employees should be covered by qualified profit-sharing plans. In our opinion, the enactment of H.R. 6410 would inhibit this objective rather than encourage it. The philosophy behind the bill apparently assumes that by drastically reducing the limitations on contributions and benefits, and by imposing other restrictions and limitations under qualified pension and profit-sharing plans, there will be a broadening of the base of employees covered by such plans.

There is no evidence that such a result will follow. In fact, commonsense dictates that the more restrictions placed on plans, the less appealing they become to employees and employers alike. In short, the proposed legislation would impose too great a cost to participants in profit-sharing plans when measured against the benefits sought to be gained.

The formal statement we submitted gives our detailed objections to the bill. First, the bill will adversely affect rank-and-file employees. The reduction of the aggregate limit from 1.4 to 1 will affect all employees in those companies which presently maintain both a defined benefit and a defined contribution plan and contribute the maximum allowable amount.

Second, the reduction of limits and abolition of automatic adjustments would affect more and more employees as time goes on. The bill does not take into account the fact that profit-sharing contributions are made from profits. I think all of us are aware that many companies last year and this year were not profitable. In many cases, profit-sharing contributions were minimal or entirely absent.

In 1984 if profits return to their normal level, the application of the carry-forward provision of section 404 of the Code and the section 415 limitation under the new bill will be in conflict. Thus, companies will have difficulty catching up for the lean years.

In summary, arbitrarily placing frozen limits on profit sharing would result in social and economic detriments far and above any revenue or other tax benefits hoped for by H.R. 6410.

Thank you for the opportunity to appear here.

[The prepared statement follows:]

STATEMENT OF WALTER HOLAN, PRESIDENT, PROFIT SHARING COUNCIL OF AMERICA

My name is Walter Holan and I am President of the Profit Sharing Council of America. I am accompanied by John A. Cardon of the Washington law firm of Lee, Toomey and Kent, attorneys for the Council. The Council is a non-profit association of approximately 1,400 employers who have profit sharing plans. These plans cover about 1,750,000 employees. Council members are located throughout the United States and are engaged in practically all areas of economic activity. Member companies range in size from Fortune top 200-size companies down to the "ma and pa" family operation.

The Council defines profit sharing as any procedure under which an employer pays or makes available to employees subject to reasonable eligibility rules, in addition to prevailing rates of pay, current or deferred sums based on the profits of the business. Under deferred profit sharing plans the employer contributions are allocated to an employee's account, together with the employee's own contributions, if any, and those sums are then invested for the benefit of the employee and subject to investment risk. At retirement all of the Company contributions, the employee contributions, the gains or losses, and the reinvested earnings are made available to the employee for his retirement benefit. The Council estimates there are approximately 17 million employee participants in about 315,000 deferred profit sharing plans. Employee profit sharing trusts now hold over $75 billion in invested assets on behalf of these participants.

The Council and its member companies actively participated in hearings during the development of the Employee Retirement Income Security Act of 1974. Since ERISA the Council and its members have likewise taken the opportunity to work with the Internal Revenue Service and the Department of Labor in developing regulations promoting the orderly administration and regulation of tax-qualified profit sharing plans. Today, almost eight years after its enactment complete final regulations under all sections of ERISA have not yet been issued. A joint task force of IRS, Treasury and Labor Department officials continues to review its operation. A special Presidential Commission of experts in the area has met and offered its recommendations. If any one lesson should have been learned by the experience of the last eight years, it is that for every action taken in the pension area, there are complex and often unanticipated consequences.

The Council is opposed to the enactment of H.R. 6410 because of the far reaching ramifications it would have on qualified profit sharing plans and the private retirement sector generally. If enacted as proposed, it would inhibit the creation of new profit sharing plans and jeopardize the continuing existence of those plans already qualified under Section 401(a) of the Internal Revenue Code. We are particularly concerned because these changes would come at a time when public confidence in the Social Security System is at an all time low. Now, more than ever, the private sector should be given every opportunity to expand and take up the "slack" in providing retirement savings.

The Council agrees that the broadest possible class of employees should be covered by qualified profit sharing plans. In our opinion, the enactment of H.R. 6410 would inhibit this objective rather than encourage it. The philosophy behind the Bill apparently assumes that by drastically reducing the limitations on contributions and benefits, and by imposing other restrictions and limitations under qualified pension and profit sharing plans, there will be a broadening of the base of employees covered by such plans. There is no evidence that such a result will follow. In fact, common sense dictates that the more restrictions placed on plans, the less appealing they become to employees and employers alike. In short, the proposed legislation would impose too great a cost to participants in profit sharing plans when measured against the benefits sought to be gained.

Following are the major points in the Bill to which the Council objects:

Freezing maximum benefit limits at a level below those currently in force, and without automatic adjustments for future increases in the cost of living would actively discourage new and existing private profit sharing plans. At the present time the maximum annual addition to a profit sharing plan under Section 415 of the Code includes employer contributions, forfeitures, and a portion of employee contributions. A large number of Council members have employees who actively contribute after tax dollars to such plans. Reducing the maximum benefit limits in these cases would discourage voluntary employee contributions. Recently Congress in the Economic Recovery Tax Act of 1981 expanded the Internal Revenue Code in Section 219 to stimulate employee savings by allowing participants in qualified retirement plans to contribute to individual retirement accounts or make deductible contributions to employer plans.

Limiting the annual additions to profit sharing plans generally would run counter to an apparent Congressional intent to stimulate and encourage employee contributions to qualified retirement plans. Such employee contributions, whether or not tax deductible, assist employees in planning for their own retirement. They also aid in the formation of capital, and stimulate private savings. In the future, as the cost of living increases, the frozen limit would apply to a greater and greater percentage of employees; ultimately to low-paid as well as what may be today considered high-paid employees. While it is possible that Congress might from time to time raise such limits, it has not traditionally done so in the past.

The Council opposes the reduction of the aggregate limit on a participant in a defined benefit plan and a defined contribution plan from 1.4 percent to 1.0 percent. Over one-third of Council members maintain both a defined benefit and a defined contribution profit sharing plan. The proposed reduction of the limits applicable to two such plans from 1.4 to 1.0 could act to reduce the retirement benefits from the private sector for many, many thousands of employees who participate in both plans. At a time when the viability of the Social Security System is being questioned, the Council maintains it is not appropriate to so reduce pension benefits provided by the private sector.

Reducing the limitation on contributions as proposed by the Bill will adversely affect the ability to make additional contributions to profit sharing plans to make up for years of lean profits. Section 404(a)(3)(A) allows a deduction for contributions to a profit sharing plan equal to 25 percent of participants' compensation, rather than the normal 15 percent of such compensation in years in which carry-forwards from prior years when contributions were under the deductible limit of 15 percent of compensation. Since contributions to profit sharing plans are generally made only in years when profits occur, this is an especially important provision for employees whose primary source of retirement benefits is a profit sharing plan. In those cases an employer will often average 15 percent contributions over a period of years, but make them in varying amounts in each year depending on profits. By reducing and capping the annual addition amounts of Section 415 of the Code, an employer's ability to use the carry-forward feature of Section 404 of the Code would be greatly inhibited since the annual addition cap of Section 415 would not be carried forward. The employee participants would be the losers under these conditions.

Cutting back the maximum contribution fraction from 1.4 to 1.0 for combinations of plans will affect the makeup provisions of Section 404(a)(3)(A) in a similar manner.

The Bill would provide that a plan which is integrated with Social Security could not provide for an offset of more than employer-attributable contributions to Social Security for the employee in each year. While conveniently simple, the concept unfortuately bears no practical resemblance to the real world or generally accepted actuarial principles. The amount contributed by an employer on behalf of each employee in 1982 goes for the payment of current benefits to other retired employees and is in no way related to the future benefits to which that employee may be entitled from the Social Security System.

The Bill as proposed would apply certain loan prohibitions to key employees. For purposes of the Bill key employees are defined as officers, 5 percent owners and those among the highest paid 15 percent of all employees. For most employers, this percentage could very well include employees who would almost certainly be classified among the lower paid employees based on their dollar earnings alone. Loan provisions in profit sharing plans are a very attractive feature for participating employees, particularly in times like these when credit has not been readily available. If there is some particular abuse in this area, that matter should be addressed directly rather than by blanket restrictions found in the present Bill.

Arbitrarily placing frozen lower limits on profit sharing would result in social and economic detriments far and above any revenue or other tax benefits hoped for by H.R. 6410. Such far reaching changes should not be made in the heat of discussions on the Federal budget. Regulations enforcing ERISA have not been fully issued some 8 years after passage of the law. Acting hastily and without adequate study on complex issues such as Social Security integration, maximum benefits and other major plan qualification issues would endanger the entire private pension system through increased administative costs and arbitrary limitations without corresponding benefits.

Mr. Rangel. I assume you are all testifying that you have no problem with the last employer getting the benefits of the employee's contribution to the benefits funds.

Next question, I assume that all of you who represent pension companies believe that one of the things you should do is to maximize the pension benefit for the executive type of employee and to minimize the cost of that pension program to the particular purchaser.

Does anyone object to that type, Mr. Holan?

Mr. **Holan**. What do you mean by maximize? All profits are shared on the basis of maximization of profit sharing.

Mr. **Rangel**. At the least possible cost. That is——

Mr. **Holan**. Not in profit sharing. It is a cost in that sense but the greater the profits go up, the greater the cost to the company, the greater the share.

Mr. **Rangel**. As it relates to the loan provisions, Mr. Marshall, I think in your testimony you made it appear as though it was the same as with a bank, you really did not mean that, did you?

Mr. **Marshall**. I clearly did not mean to indicate that——

Mr. **Rangel**. A large pension fund for deferring the money that is the same as borrowing from the bank.

Mr. **Marshall**. A loan from a qualified plan does not represent a distribution.

Mr. **Rangel**. You did not mean to say that is the same as going to a bank and getting a loan.

Mr. **Marshall**. That is correct.

Mr. **Rangel**. I have no further questions.

Chairman **Rostenkowski**. Thank you for joining us this morning.

Mr. Moran, Mr. Cassidy, Mr. Nolan, Mr. Diamond, and Mr. Boynton, welcome to the committee. We look forward to your testimony.

Mr. Moran, if you will identify yourself for the record, you may proceed with your testimony.

STATEMENT OF CHARLES A. MORAN, SENIOR VICE PRESIDENT, MANUFACTURERS HANOVER TRUST CO., AND CHAIRMAN, EMPLOYEE BENEFIT SERVICES COMMITTEE, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY THOMAS PARFITT, VICE PRESIDENT, HARRIS TRUST & SAVINGS BANK

Mr. **Moran**. Thank you. I am Charles Moran. I am senior vice president of Manufacturers Hanover Trust Co., and I am presently serving as chairman of the Employee Benefit Services Committee of the Trust Division of the American Bankers Association. It is in that capacity that I come here today.

I am joined by Thomas Parfitt, vice president of Harris Trust & Savings Bank, and former member of the ABA's Compensation/Benefits Committee.

The American Banker's Association is pleased to have an opportunity to contribute to this hearing. The ABA has consistently supported incentives to broaden the coverage of pension plans.

I believe Congressman Rangel stated this was an objective of H.R. 6410. However, we believe this bill, if enacted, would have a major negative impact on the private pension plan system.

It is important to recognize that pension policy has been, and continues to be, the result of a matrix consisting of social issues and tax issues. Not only must these issues be considered individually, but an additional dimension is added by the interaction of each set of issues with the other.

A further complexity is the impact on savings and investment of pension policy. It is this complex interaction of these important issues that has resulted in a history of lengthy debate on pension legislation.

Certainly the long hours that both Houses of Congress and various committees and subcommittees have devoted to these issues recognize the importance of well-conceived and implementable pension policies.

Our written comments cover all of the provisions of the pending legislation, but I will address myself to two points.

As you are aware, when the practical application of the strict nondiscrimination requirement is examined in conjunction with the proposed limits on contributions and benefits, there are several undesirable results.

As benefit and contribution levels for all participants must be proportionately related to compensation, reductions for more highly compensated employees would result in reductions for the rank-and-file employee as well.

It is also a certainty that restrictions on benefits for one class of employees, namely the more highly compensated, would be a disincentive to improving benefits for all employees and the establishment of new plans.

It would be highly desirable for the economy if we were discussing the merits of totally eliminating the existing contribution and benefit limits. It is not news that it is difficult to find any subject upon which economists can agree, but most economists do agree that increased levels of savings and the resulting increase in investment are critical to our economic health. Any limit on the deductibility of contributions reduces savings and investment.

The replacement of a 1.4 ratio with a 1.0 ratio where an employee is covered by both a defined contribution plan and a defined benefit plan will reduce benefits for 80 percent of employees.

In 1974 Congress received more mail from constituents on this limit than on any other aspect of ERISA. This proposed rule will reduce benefits for long service employees at all salary levels.

Further, the incentive to increase savings that is implicit in salary reduction, cash or deferred and similar plans would be reduced by restrictions in the bill. Voluntary contributions would also be prevented.

We have examined the impact of the proposed 1.0 ratio on a typical bank with both a defined benefit and defined contribution plan. Over 80 percent of all employees will have their benefits reduced, and that certainly includes the high paid employees as well. However, those earning over $48,000 per year represent only 6 percent of those whose benefits will be reduced. Those earning $24,000 to $48,000 represent another 24 percent. Those earning less than $24,000 a year, 70 percent of those whose benefits will be reduced; in fact, 12 percent represents employees earning less than $12,000 per year.

The ABA members will be submitting additional data for the record on similar cases. I believe this example makes it clear why

Congress should expect to hear from their constituents again on the proposed ratio.

The changes proposed in H.R. 6410 would require existing pension plans to incur substantial administrative costs with no resulting benefits to plan participants and beneficiaries. This would have the result of discouraging the continuation and improvement of existing plans and inhibiting the establishment of new plans.

This reduction is contrary to the Congress policy articulated in the economic recovery tax bill. Any projected revenue gains—we have not had the opportunity to scrutinize those gains—from H.R. 6410 must be weighed against the bill's damage to the private pension system and the resulting increase in reliance on the strained social security system.

Now is the time to strengthen and expand the private pension system not to attack and plunder it.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman, I am Charles A. Moran, Senior Vice President, Manufacturers Hanover Trust Company and also Chairman of the Board of MH/Edie Investment Counsel, Inc., an investment management subsidiary of the bank. Presently I serve as Chairman of the Employee Benefit Services Committee of the Trust Division of the American Bankers Association. I am accompanied today by Mr. Thomas E. Parfitt, Vice President, Harris Trust & Savings Bank and former member of the ABA's Compensation/Benefits Committee. ABA is a national trade association whose members consists of more than 13,000 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another.

The American Bankers Association is pleased to have an opportunity to contribute to this hearing on H.R. 6410, the Pension Equity Tax Act of 1982. We notice that Congressman Rangel has stated, "A major objective of the bill is to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax subsidized pension and statutory fringe benefit plans." The ABA has consistently supported efforts to broaden the coverage of pension plans. We have also pointed out that qualified plans benefit from a system of tax deferral and not tax subsidy.

The second major objective attributed to H.R. 6410 by Congressman Rangel is ". . . to reduce the excessively high tax limits on tax-free accumulations under corporate pension plans." The following comments will point out the extent to which this bill reduces incentives for broad coverage and clarifies the frequent misconception that limits on accumulations are somewhat excessively high.

H.R. 6410, if enacted, would have a major negative impact on the private pension plan system. It is important to recognize that pension policy has been and continues to be the result of a matrix consisting of social issues and tax issues. Not only must these issues be considered individually but an additional dimension is added by the interaction of each set of issues with the other. A further complexity is the impact on savings and investment of pension policy. It is this complex interaction of these important issues that has resulted in a history of lengthy debate on pension legislation. While the length of the debate has been frustrating to many of us, the importance of studying the impact of individual policy objectives on the entire matrix is recognized by everyone involved with the private pension system. Certainly the long hours that both Houses of Congress and various committees and subcommittees have devoted to these issues recognize the importance of well-conceived and implementable policies.

DISINCENTIVES TO PENSION PLANS

Congress has over the years set minimum levels of compensation for employees. However, with the exception of brief periods of wage and price controls, Congress has never put a maximum limit on employee compensation.

It has been estimated that up to two-thirds of the employees of large and small corporations would have their compensation reduced by the effects of H.R. 6410. This results from the combined effect of:

I. Reducing the limits for contributions to defined contribution plans and retirement benefits of defined benefit plans from $45,475 and $136,425 respectively to $30,000 and $90,000. Repealing the formula for annual adjustment of those limits further exacerbates the problem. As you are aware, Congress has assured that qualified retirement plans meet strict nondiscrimination tests. When the practical application of this requirement is examined in conjunction with the proposed limits on contributions and benefits there are several undesirable results. As benefit and contribution levels for all participant must be proportionately related to compensation, reductions for more highly compensated employees would result in reductions for the rank and file employee as well. It is also a certainty that restrictions on benefits for the more highly compensated would be a disincentive to improving benefits for all employees and the establishment of new plans.

It would be highly desirable for the economy if we were disussing the merits of totally eliminating the existing contribution and benefit limits. It is not news that it is difficult to find any subject upon which economists can agree, but most economists do agree that increased levels of savings and the resulting increase in investment are critical to our economic health. Any limit on the deductibility of contributions reduces savings and investment.

The use of the term COLA (cost-of-living-adjustment) in attacking annual adjustments in limits on contributions and benefits is misleading. First, it should be noted that COLAs increase inflationary pressure whereas increases in savings have the opposite effect. Second, it must be recognized that the increases are not in benefits paid each year, but rather increases in amounts contributed and deferred (i.e., saved and invested) in the current year.

II. The replacement of the "1.4 ratio" with a "1.0 ratio" where an employee is covered by both a defined contribution plan and a defined benefit plan. In 1974 Congress received more mail from consitutents on this limit than on any other aspect of ERISA. This proposed rule will reduce benefits for long service employees at all salary levels. It is anticipated that the "1.0 ratio" would require any employer who maintains more than one plan "including union plans" for his employees would be required to amend the benefit and contribution formula resulting in a reduction in the anticipated benefit of most employees. Further, the incentive to increase savings that is implicit in salary reduction, cash or deferred and similar plans would be reduced by restrictions in the bill.

The prohibition against loans to "key employees" and to all participants in cash or deferred plans should be reconsidered on two grounds. First, loans which are permitted under current law only on an arms-length nondiscriminatory basis are advantageous to employees. This makes plans more attractive to all employees and when repaid satisfies the public policy of providing retirement income which the alternative, a hardship distribution, would not. Second, prohibiting loans to one arbitrary class of plan participants ("key employees" and participants in cash or deferred plans) would influence plans to eliminate loans to all employees.

The issue of integration of private pension plans with social security has been debated at length for years and yet even today the issues are understood by only a few, if any, highly skilled technicians. In light of this, it seems only reasonable that the National Commission on Social Security Reform, which is to report in December of this year, should be heard from before the integration proposal in H.R. 6410 is evaluated.

The proposed restrictions on plans covering the self-employed and certain employees of Professional Service Corporations seem to discriminate against one type of individual and to the extent that they would cause plan terminations would result in the loss of plan benefits for the employees of these self-employed and Professional Service Corporations.

It is our understanding that the proposed nondiscrimination standards for statutory fringe benefits would have a number of adverse affects which will be the subject of testimony by others at this hearing.

The limit on the amount of the exclusion for estate tax is another disincentive to plans and the public policy considerations for this limit have not been made clear to us.

The changes proposed in H.R. 6410 would require existing pension plans to incur substantial administrative cost with no resulting benefits to plan participants and beneficiaries. This would have the result of discouraging the continuation and improvement of existing plans and inhibiting the establishement of new plans.

Any projected revenue gains from H.R. 6410 must be weighed against the bill's damage to the private pension system and the resulting increase in reliance on the strained social security system. Now is the time to strengthen and expand the private pension system, not to attack and plunder it.

Chairman ROSTENKOWSKI. Mr. Cassidy, you may proceed with your testimony.

STATEMENT OF WILLIAM L. CASSIDY, VICE PRESIDENT, PENSION DEPARTMENT, NATIONAL LIFE INSURANCE CO., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. CASSIDY. My name is William Cassidy, vice president of the Pension Department of the National Life Insurance Co. of Vermont. I am appearing here today on behalf of the American Council of Life Insurance, representing the life insurance business.

The life insurance business supports measures to strengthen the private employee benefit system so that it may better fulfill its role of providing for retirement and other financial security of American workers and their families.

However, we are very concerned about the scope and timeliness of the provisions of H.R. 6410, which would have a significant adverse impact on many thousands of employees covered by employer financed life insurance, health insurance, and pension plans.

H.R. 6410 was first introduced in mid-May. Less than a month later this hearing is being held. It is generally assumed that your committee may consider incorporating various features of this measure into whatever tax legislation is fashioned later this month.

In view of the diverse and complicated pension issues addressed by H.R. 6410 and the bill's far-reaching public policy implications, we believe there is simply insufficient time to properly or responsibly deal with this legislation.

Employers' pension plans provide essential financial protection and security to many millions of individuals. Pension plans also perform the extremely important function of facilitating capital formation, so necessary for a dynamic economy, higher income levels and expanding employment. The expansion of this inherently desirable form of savings should be fostered.

We oppose H.R. 6410 because it would seriously impede the growth and expansion of the private retirement system. It would result in a substantial reduction in benefits for employees; alter in an undesirable manner the long-established rules regarding the integration of private pension plans with social security; impose inappropriate restrictions on plans maintained by certain types of business; and impose new unjustified uniform nondiscrimination standards on statutory fringe benefit arrangements.

While we are extremely concerned about the effect of this legislation on all qualified plans, we fear it may have a particularly negative impact on the plans of smaller employers.

In the limited time available, I would like to briefly comment on several sections of the bill. More detailed discussions are contained in the written statement, which I request be incorporated into the record of this hearing.

The various changes made in the limits on benefits and contribution, might at first seem to affect only higher paid employees.

Based on our experience, we are certain these changes will also harm lower paid employees.

The cost and burden of another wave of required changes in those plans, together with a decrease in their worth to the decision-makers, can only increase the number of plan terminations.

Even under existing plans, it is only reasonable to expect that the benefits of the lower paid will be reduced from the present level to correspond to reduced benefits for those of the higher paid.

This will be particularly true of plans of professional service corporations if they are treated in the same restrictive fashion as are unincorporated businesses.

Lower retirement benefits for the rank and file can also be expected if 1.4 is eliminated. Since the decision to establish or maintain a plan usually is in the hands of older individuals, a defined benefit plan is ordinarily chosen as being the most favorable type of plan for them.

The 1.4 rule provides an incentive to employers to also establish a defined contribution plan which is more favorable to younger participants, usually the rank and file.

If the incentive to adopt two plans of different types is eliminated, it will be the rank and file employees who will most likely be harmed since the defined contribution plan is probably the one that would either be terminated or have its benefits reduced.

We believe also that the cost of living adjustments and dollar limits should be maintained in order to continue the savings incentives for contributions to pension plans. If inflation is controlled, these limits will not continue to grow as they have in the past. If it is not controlled, increased contributions are needed to prevent the erosion of retirement values.

With regard to the drastic changes in the current integration rules which have been proposed, it seems obvious the timing is inappropriate. The entire system is under intensive examination, and reasonable examination can not be given to the way private pension plans can be coordinated with social security until we have a better idea of what it will look like in the future.

At the present time it is impossible to evaluate the effect of those proposed rules. Our written statement addresses other aspects, but I would like to summarize that we see this bill as weakening the private pension system because of the restrictions in the long-term retirement benefits and savings elements of this bill.

Thank you.

[The prepared statement follows:]

Statement of William L. Cassidy for the American Council of Life Insurance

My name is William Cassidy. I am Vice President, Pension Department of the National Life Insurance Company (Vermont). I am appearing here today to present the views of the American Council of Life Insurance on H.R. 6410, the Pension Equity Act of 1982. The Council has a membership of 524 life insurance companies which, in the aggregate, have 96 percent of the life insurance in force in the United States and hold 99 percent of the reserves for insured pension plans.

GENERAL COMMENTS

The life insurance business supports measures to strengthen the private employee benefit system so that it may better fulfill its role of providing for the retirement and other financial security of American workers and their families and encourages the growth of this system, to cover additional employees and improve benefits under existing plans. However, we are very concerned about the scope and timeliness of the provisions in H.R. 6410 which would have a significant adverse impact on many thousands of employees covered by employer-financed life insurance, health insurance and pension plans.

The Council shares the general concern with the large budget deficit and its adverse impact on the economy. It is extremely important that action be taken to reduce the deficit as quickly as possible. We strongly believe, however, that adoption of H.R. 6410 is clearly an undesirable way of seeking to balance the budget because it will discourage retirement savings at a time when such savings must be encouraged. Employer-sponsored pension plans provide essential financial protection and security to many millions of individuals. Pension plans also perform the extremely important function of facilitating capital formation so necessary for a dynamic economy, higher income levels and expanding employment.

At the end of 1980, for example, the investments backing up private pensions amounted to $423 billion, with those administered by life insurance companies alone approaching $166 billion. These funds are at work in our economy helping to create jobs and improved standards of living. They help build and modernize plants, schools and hospitals. They provide places for people to live, work, shop and play. They help stabilize our economy. In addition to all this, the money invested by the life insurance business helps to provide guaranteed financial protection for millions of retirees and their families.

Retirement savings are an efficient allocation of national resources because they are drawn from the very broad base of personal income and then are directed to productive uses through diversified investments. The resulting accumulation of investment funds is put to work immediately to serve capital needs throughout the entire economy. The expansion of this inherently desirable form of savings should be fostered.

H.R. 6410 would impede the growth and expansion of the private retirement system. It would (1) result in a substantial reduction in benefits for many employees; (2) alter, in an undesirable manner, the long-established rules regarding the integration of private pension plans with Social Security; (3) unfairly impose inappropriate restrictions on plans maintained by certain types of businesses; and (4) impose new unjustified uniform nondiscrimination standards on statutory fringe benefit arrangements.

Particularly troubling, Mr. Chairman, is the very short amount of time which the Congress, the Administration and those actively involved in the private pension system have to thoroughly and thoughtfully consider this legislation.

H.R. 6410 was first introduced in mid-May. Less than a month later, this hearing is being conducted. It is generally assumed that your Committee may consider incorporating various features of this measure into whatever tax legislation is fashioned later this month.

In view of the diverse and complicated pension issues addressed by H.R. 6410 and the bill's far-reaching public policy implications, we believe there is simply insufficient time in which to properly or responsibly deal with this legislation. Consider, if you will, the careful and deliberate manner in which ERISA was enacted almost a decade aago. While the same amount of time may not be necessary to fashion a measure to deal with the issues raised by H.R. 6410, we very strongly believe that more than the time remaining before the tax bill is developed is needed to properly consider H.R. 6410.

The life insurance business is eager to work with you, the Treasury Department, and others in the private sector concerned about providing for the retirement needs of our fellow citizens to develop meaningful and substantive solutions to the problems which confront the private pension system today. However, we must urge that H.R. 6410 not be enacted.

SPECIFIC COMMENTS

Contribution and benefit limits.—Section 2 of H.R. 6410 would drastically reduce the current limits on contributions and benefits. It would also eliminate any cost-of-living increases in these limits. Where an employer maintains both a defined benefit and a defined contribution plan, the present ceiling of 140 percent of the separate limits otherwise applicable to each plan would be reduced to 100 percent. Finally, retirement benefits payable before age 65 could not, in the future, exceed the actuarial equivalent of the $90,000 maximum annual benefit payable at age 65.

We strongly urge rejection of this section because its enactment would have a far-reaching adverse impact on pension plans and their participants. Reducing maximum limits appears on the surface to affect only the highly compensated. In reality, however, the benefits of many other employees are likely to be reduced because pension plans generally maintain a relationship between the benefits paid to employees at different compensation levels.

The decision to establish a retirement plan and decisions on the level of benefits to be provided under such plan, are necessarily made by the principal owners of a business. If the benefits available to these people are substantially cut back, the plan is likely to be amended to also cut back the benefit available to the rest of the employees. For example, if the new limitation would operate to reduce the contribution on behalf of the higher paid employees, a comparable reduction would be likely for all employees.

Lower retirement benefits for the rank and file can also be expected if the 1.4 rule is eliminated. Since the decision to establish or maintain a plan usually is in the hands of older individuals, a defined benefit plan is ordinarily chosen as being the most favorable type of plan for them. The 1.4 rule provides an incentive to employers to also establish a defined contribution plan (thrift or savings plan) which is more favorable to younger participants, usually the rank and file. If the incentive to adopt two plans of different types is eliminated, it will be the rank and file employees who will most likely be harmed since the defined contribution plan is probably the one that would either be terminated or have its benefits reduced.

We also believe that the cost-of-living adjustments in the dollar limits should be maintained in order to continue the savings incentives for contributions to pension plans. If $25,000 was a reasonable limit on a contribution to a defined contribution plan in 1974, $45,475 is equally reasonable today. If inflation is controlled, these limits will not continue to grow as they have in the past. And if it is not controlled, increased contributions are needed to prevent the erosion of retirement values.

Finally, we believe the actuarial adjustment to the defined benefit limits where benefits begin before age 55 should not be changed. The required actuarial reduction under H.R. 6410 for benefits that begin before age 65 will reduce the retirement income of any individual who decides to retire early. Regardless of what dollar limit is considered reasonable, if an employee retires prior to age 65 either because that is normal for the business or because the participant has become disabled, why is it that a much lower income becomes sufficient? These individuals should be allowed to retire with a sufficient retirement income to prevent a significant reduction in living standards after retirement.

Integration.—Section 4 of H.R. 6410 would substantially change the rules of integrating private pensions and Social Security. We strongly urge rejection of this section because its enactment would retard the development of pension plans and make it difficult to properly coordinate pension and Social Security benefits under a rational system of providing retirement income for American workers.

Since 1942, the Internal Revenue Code has recognized the need to intergrate the benefits provided by qualified retirement plans with Social Security benefits for purposes of applying the requirement that such plans must not discriminate against rank and file employees. Present integration rules permit private plans to take credit for that part of Social Security benefits which is considered to be financed by employers in general for purposes of determining whether benefits or contributions are nondiscriminatory. More specifically, a qualified plan is permitted to combine the designated portion of Social Security benefits or contributions with its benefits or contributions for purposes of meeting the test that benefits or contributions must not form a larger percentage of compensation for owners, officers or highly compensated employees than for rank and file employees.

Section 4 of H.R. 6410 would revise these rules drastically. Under defined benefit plans, the proposed new integration rules would permit an employee's annual pension benefit to be reduced by no more than the annual benefit which could be purchased with the aggregate Social Security (OASDI) taxes actually paid by the retiring individual's employer on his behalf. Thus, the amount of Social Security benefits so taken into account would exclude benefits attributable to Social Security taxes paid by prior employers. It would also exclude the "insurance" element of Social Security benefits, i.e., that part of an individual's Social Security benefits which exceeds the benefits that could be purchased for him by the Social Security contributions made on his behalf during his working career.

For profit-sharing and other defined contribution plans, section 4 would permit an employer to reduce plan contributions on behalf of an employee by no more than an amount equal to the employee's taxable wage base multiplied by the actual Social Security (OASDI) tax rate—5.4 percent for 1982, 1983 and 1984.

We cannot be sure what the impact of the new rules would be because they are so completely dependent on the rules which Treasury, in its own discretion, is to develop. Actuarial calculations show the extreme difference in results which can occur due to a small change in just one of the several assumptions which Treasury is empowered to dictate. Assume the following:

(a) Contributions at a level of 5.4 percent, made at the beginning of the year;
(b)— Mortality based on 1971 GAM;
(c) Male, age 35, to retire at age 65;
(d) 0 percent expense.

The resulting projection of the benefit which could be purchased by the aggregate taxes paid by the employer if an interest rate of 5 percent is assumed is equal to 38 percent of current pay; but a change in only the interest assumption to a 7 percent rate would increase the projected benefit to 63 percent of pay.

This means that if the private pension plan in which an employee participated were to provide a pension equal to 80 percent of compensation, offset by the benefit projected to be available from the Social Security tax, the employee's pension from the private plan would be 42 percent of pay under the 5 percent assumption but only 17 percent under the 7 percent assumption.

We are concerned that the proposed changes might be interpreted to reduce the Social Security benefits that can be taken into consideration under integration. Present integration rules do not limit the amount of Social Security benefits taken into consideration under defined benefit plans to the specific amount of benefits that could be purchased by the Social Security tax contributions made by the retiring employee's present employer. Instead, the present rules recognize the tax contributions made by all employers including past, as well as present, employers of retiring individuals. In addition, present integration rules recognize the "insurance" element of Social Security benefits in that the benefits they now take into consideration generally substantially exceed those that could be financed by the OASDI tax contributions actually paid for particular employees.

For profit-sharing and other defined contribution plans, the present integration rules allow up to 7 percent of the taxable wage base to be taken into consideration. In contrast, section 4 of the bill would allow only 5.4 percent of this wage base to be taken into consideration in 1982, 1983 and 1984.

It would be particularly inappropriate to make the drastic changes in integration contemplated by section 4 at the present time when the entire Social Security program is being thoroughly reexamined by the National Commission on Social Security Reform. This bi-partisan Commission, which is charged with making recommendations to place Social Security on a sound financial basis, is scheduled to make its report to the President by December 31, 1982. Since the Commission may well recommend Social Security changes which would have fundamental repercussions on the integration rules, at a minimum, it would be desirable to await its report before taking any action to revise these rules.

Moreover, the change in the integration rules provided by section 4 would not be in the long-run best interest of employees. The latter is best served by rules which coordinate private plan benefits and Social Security benefits in a way that produces combined benefits that are reasonable in relation to pre-retirement earnings at different earnings levels. However, such a reasonable result cannot be secured by the approach taken by section 4 which generally limits the amount of Social Security benefits recognized for integration purposes to the benefits that could be purchased by the last employer's OASDI tax contributions. Such an approach does not recognize the fact that Social Security benefits replace a very much larger portion of pre-retirement earnings at the lower earnings levels than at the higher earnings levels. Instead, it would reduce the amount of Social Security benefits recognized for integration purposes to the point where plans would be required to provide low paid employees retirement benefits which, together with Social Security benefits, are unreasonably high in relation to (or even in excess of) pre-retirement compensation in order to be able to pay realistic retirement benefits to employees in the middle and upper compensation levels. In addition to providing an irrational retirement benefit structure at different income levels, this would retard the development of pension plans by greatly increasing the cost to employers of providing employees above the lower compensation levels with benefits comparable to those they now possess.

In addition, it does not make sense to base integration on the specific amount of benefit that could be purchased from contributions made on behalf of particular employees. To be realistic and fair, integration procedures must be based on the substantially higher actual Social Security benefits. This is because Social Security benefits represent intergenerational transfers of income and the benefits paid to the current retired individuals are, in effect, financed by the contributions of current taxpayers. Most individuals retiring at the present time and for a considerable period to come, will receive Social Security benefits over their lifetime which far exceed the total employer and employee contributions put into the system.

Finally, the safe harbor integration rules provided by section 4 are not satisfactory for much the same reasons that the proposed general integration rules discussed above are not satisfactory. Under these proposed safe harbor rules, a plan would be considered properly integrated with Social Security if (1) the rate of contributions or benefits for compensation in excess of $30,000 but less than $60,000 is not more than twice the rate for compensation below $30,000 and (2) the rate for compensation in excess of $60,000 is not greater than the rate for pay less than $30,000. Like the general proposed integration rules discussed above, these arbitrary safe harbor rules fail to recognize that Social Security benefits are much higher as a percentage of compensation at low-income levels than at high-income levels. Accordingly, they too have the inherent defect of requiring plans wishing to qualify under the Internal Revenue Code to provide unreasonably high combined Social Security and private benefits at lower-compensation levels in order to pay reasonable combined benefits at middle and high compensation levels.

In conclusion, we strongly recommend that the question of a legislative reexamination of the integration rules be deferred until after the National Commission on Social Security Reform has submitted its report at the end of this year. Moreover, if there is to be a reexamination at that time, it should be based on two important principles: First, a plan should be permitted to satisfy the integration rules if the combined Social Security and pension benefits are not higher in relation to compensation for higher-paid than for lower-paid employees. And second, no plan should be required to provide a benefit which, together with Social Security benefits, replaces more than 100 percent of pre-retirement income.

Plans covering self-employed individuals and employees of professional corporations.—Sections 5 and 6 of H.R. 6410 would make important changes in the treatment of self-employed individuals covered by H.R. 10 plans and certain employees of professional corporations. These sections (1) increase the maximum deduction dollar limit for employer contributions to defined contribution H.R. 10 plans from $15,000 to $30,000. The 15 percent limit on contributions is not changed; (2) extend certain of the special owner-employee H.R. 10 rules (including those relating to participation, vesting and specified restrictions on contributions, benefits and distributions) to plans covering partners whose individual partnership interests do not exceed 10 percent; and (3) extend the H.R. 10 rules to plans of professional service corporations. Shareholder-employees of such corporations with a 10 percent or more ownership interest would be treated as owner-employees under the pension rules.

While we are in favor of increasing the amounts of deductible contributions that self-employed individuals can make to H.R. 10 plans when revenue and budgetary conditions permit, we strongly believe that the overall effect of sections 5 and 6 would be inequitable and detrimental to the development of pension plans. We find the proposed extension of the H.R. 10 rules to personal-service corporations particularly objectionable. Although the stated objective is to promote uniformity of treatment, the practical result of sections 5 and 6 would be to discriminate markedly against shareholder-employees of such corporations.

Personal-service corporations are just as much corporate entities as other corporations. There is no apparent justification for singling out the shareholder-employees of such corporations for less favorable treatment under the pension laws than shareholder-employees of other corporations. Yet the bill would do precisely that by imposing the H.R. 10 rules on the designated personal service corporations—namely, those corporations whose principal function lies in the fields of health, law, engineering, architecture, accounting, actuarial science, the performing arts, athletics or consulting. The result would be to set considerably lower limits on the pension contributions on behalf of the owner-employees of such personal-service corporations than would apply generally to corporate employees. This would not only be highly punitive to the shareholder-employees of personal-service corporations, it would also be likely to slow down the growth of pension plans covering employees of such corporations and result in major benefit losses to rank and file employees. If the limits on pension contributions to personal-service corporations are reduced, and, if most such plans may no longer be integrated, and if they lose what little flexibility they now have with respect to participation and vesting rules, plans will be terminated. The shareholder-employees will take the funds thus released as current compensation and invest them in some other way, and the employees will be the losers.

Extension of the H.R. 10 rules to personal-service corporation plans would also involve complex and arbitrary distinctions in the law which would be difficult to administer and which would exacerbate the complexity of the Internal Revenue Code.

Finally, we do not believe that it would be desirable to extend the owner-employee rules to partners in H.R. 10 plans whose individual partnership interests do not exceed 10 percent. This is because partners with such relatively small ownership interests individually are not likely to possess sufficient authority over the plan to warrant the application of the owner-employee rules.

In view of the substantial contribution of pension plans in providing needed retirement income to covered employees and in helping to accumulate the capital formation required by a growing, dynamic economy, uniformity in the treatment of owner-employees under corporate plans and H.R. 10 plans should be sought through raising the allowable deductible contributions under the H.R. 10 plans rather than through restricting contributions for those covered by corporate plans. If we are to encourage the establishment of new plans, we must stimulate, not discourage, action by smaller firms and self-employed persons since they involve the major elements of the work force currently not covered by private pension plans.

Loans to participants.—Section 3 of the bill would replace the present rules regarding loans by qualified plans to participants with new more restrictive rules. Under the proposed new rules, if a key employee receives a loan from the plan or uses an interest in the plan as security for a loan, the amount received or pledged would be treated as a distribution for income tax purposes. For this purpose, a key employee includes officers, individuals with a more than 5 percent ownership interest in the employer maintaining the plan and those in the highest paid 15 percent of the employer's employees.

We urge rejection of these proposed new rules because they are unnecessary and will create numerous problems for plan participants. Loans made by qualified plans to participants are now subject to reasonable conditions designed to prevent abuse. Present law, for example, generally requires that qualified plan loans to participants must bear a reasonable rate of interest, be adequately secured, provide a reasonable repayment schedule, and be made available on a basis which does not discriminate in favor of employees who are officers, shareholders, or highly compensated individuals. Moreover, the definition of "key employee" is so broad (top 15 percent of employees) that in a large plan, for example, thousands of employees could be "key employees".

In addition, prohibiting loans to "key employees" could cause many plans to be amended to prohibit loans for all employees. The inability of rank and file employees to borrow from their plans may aggravate existing financial difficulties if additional money is temporarily needed to meet a medical emergency, educational expense for a child or other hardship situation. Moreover, a broad prohibition against loans may discourage employers from adopting plans and employees from participating in plans. This would result in another impediment for employees to accumulate needed personal funds for retirement.

Welfare benefit plan discrimination.—Section 7 of the bill would establish new nondiscrimination standards for many types of statutory fringe benefit programs, including group-term life insurance plans and accident and health insurance plans. If a plan does not meet the new discrimination tests in terms of both participation in the plan and benefits provided under the plan, the "key employees" would have to include in income the "cost" of the fringe benefits provided to them under such plan.

While the basic objective of the proposal may be desirable, no justification has been presented for changes in the long-established rules that currently exist. In group-term life insurance plans of small employers (those employing fewer than 10 employees), for example, there is already a nondiscrimination rule in effect, since all employees (with minor exceptions) must be covered and amounts of insurance are carefully controlled.

Among large employers, the rank and file generally receive significant amounts of life insurance protection and if there is any discrimination, it would normally be with respect to amounts in excess of $50,000, which is already subject to tax. However, if a plan of a large employer fails to meet the new proposed nondiscrimination standards, it is more likely that the group-term coverage of the higher paid will be cut back and the employer will provide equivalent benefits through another form. The cost of raising the benefits for the rank and file to meet these new rules could be prohibitive. Thus, we seriously question whether the proposal would have its intended effect of broadening coverage.

Also, the potential revenue that might be derived from trying to impose new nondiscrimination requirements would hardly be worth the cost in terms of regulatory and taxpayer compliance expense. In view of the fact that taxpayers who receive more than $50,000 of group-term life insurance are already required to take the cost of such insurance into income, the revenue impact of this proposal would be small.

We believe it is necessary to focus on the unsettling effect this proposal would have, if enacted, on the welfare benefit plan community in general, including the plans themselves, their sponsors and those institutions, such as life insurance companies, which sell products to, and service, these plans. To this end, we urge that consideration of the proposal be deferred until an impact study is completed so that the perceived benefits to be derived can be weighed against the probable effect of the new requirements on life and health insurance in this country. The experience under ERISA shows clearly that, unless carefully designed, well motivated legislation can, because of its complexity and burdensome requirements, have far-reaching consequences in terms of retarding the growth of plans.

CONCLUSION

We appreciate having the opportunity to present the views of the American Council of Life Insurance on these very important proposals. Before closing, we would like to emphasize again the importance of creating a favorable environment for private pension plans in order to encourage adequate retirement income and to help supply the capital needed for a dynamic economy. Accordingly, we urge the rejection of H.R. 6410 which would discourage the formation of new plans and the expansion of existing plans.

We would be happy to answer any questions the Committee might have and to furnish any additional information the Committee might desire.

Chairman **Rostenkowski**. Mr. Nolan, you may proceed.

STATEMENT OF JOHN S. NOLAN, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY JAMES T. O'HARA, CHAIRMAN, LEGISLATIVE SUBCOMMITTEE, STANDING COMMITTEE ON RETIREMENT OF LAWYERS

Mr. **Nolan**. I am John Nolan, chairman of the section of taxation of the American Bar Association, accompanied by James T. O'Hara, chairman of the legislative subcommittee of the standing committee on retirement of lawyers. We speak today for the American Bar Association, 275,000 lawyers throughout the United States. I am particularly pleased that our position in many respects closely parallels that of the Treasury Department.

Congressman Rangel has focused attention on H.R. 6410 on major questions of tax policy dealing with the private pension system. His stated objective is to provide greater incentives for comprehensive inclusion of the broadest possible class of employees in qualified pension and statutory fringe benefit plans. The American Bar Association enthusiastically applauds Congressman Rangel for his effort to achieve this objective. At the same time, however, we urge that this committee move slowly and carefully to determine the extent to which the individual provisions of this bill would achieve this goal.

A critical element in revising our private pension system must be equality of treatment of the self-employed. H.R. 6410 takes some steps in that direction but then, unfortunately, fails to complete those steps. Perhaps unintentionally, it also takes some steps backward that will increase the existing discrimination within the private pension system. This is not only unfair, it would be unsound tax, economic, and social policy.

Equality of treatment reflects a broader policy that tax provisions governing the private pension system should not discriminate to any extent based on the form of organization of the business. Further, they should apply evenhandedly with respect to all employees similarly situated, whether employed by capital-intensive or service-intensive businesses, whether large or small business.

Section 2 of the bill would reduce the existing dollar limitations on contributions and benefits. Section 8 of the bill would limit the estate tax exclusion. Sections 2 and 8 would apply evenhandedly with respect to all participants in qualified plans, and accordingly, we take no position on them. We observe, however, that reductions in the limits on contributions and benefits present other fundamental issues of private pension policy that must be considered by this committee. Also, section 2 would eliminate any cost-of-living adjustment to the dollar limitations. The particular cost-of-living adjustment formula in existing law is probably too generous, but it seems unwise completely to repeal any such adjustment factor. The net result of doing so will be to impose a gradually reducing set of limits as annual inflation occurs, putting constant pressure on Congress to increase such limits. Equity, simplification, and administrability are served by fixed rules which provide a long-term planning framework for business.

Section 3 of the bill would, in effect, prohibit loans to key employees. This provision also does not discriminate on the basis of the form of organization or the type or size of the business. Accordingly, again we take no position on it. We note, however, that it does create a new form of discrimination. Key employees are treated differently from other employees, without clear justification. It would be sound pension policy generally to restrict loans by plans to all employees in order to assure the funding of future benefits for retirement purposes, with very limited exceptions, such as loans in case of clear-cut economic hardship. Such restrictions, however, are as appropriate for lower paid employees as for higher paid employees.

The American Bar Association strongly supports the provisions of section 5 of the bill increasing the limit on deductible contributions for self-employed persons to $30,000. The increase, however, is largely illusory in practical effect because of the failure to eliminate the $200,000 limit on maximum earnings which may be taken into account, or at least to increase that amount to $400,000. A plan including a self-employed person would be required to provide contributions at a rate of 15 percent or more of compensation for all participants before the self-employed persons could ever reach this new limit. This would be an unreasonably high contribution rate.

This same issue arose in the Economic Recovery Tax Act of 1981 when an increase in the limit on deductible contributions by self-employed persons from $7,500 to $15,000 was adopted. After careful consideration, Congress at that time consistently increased the maximum earnings that could be taken into account from $100,000 to $200,000 so long as contributions at a rate of at least 7.5 percent were made for all participants in the plan. At the very least, the same type of consistent change should be made in section 5 of this bill.

We also strongly urge that the special limitations on defined benefit plans for self-employed persons be eliminated. These rules are designed to prevent self-employed persons from taking past service into account in adopting a qualified plan, but no such limitations are imposed upon employees of corporations in general. If self-employed persons were to take past service into account, they would be required by other provisions of law to do so also for their employees, without discrimination. The special limitations on self-employed persons in existing law unfortunately deter creation of the most desirable form of pension plan from a pension policy standpoint—the defined benefit plan. The need for these special limitations is highly questionable, but in any event, there is no reason to single out self-employed persons for such discriminatory treatment.

The time has come to focus upon the forest and not the trees. If self-employed persons are enabled to obtain significant tax induced retirement benefits at the price of very substantial coverage of their common law employees, so be it; the country will be much the richer for it.

We oppose extension of the special rules applicable to owner-employees to all self-employed persons. Prior to ERISA, there was justification for these special rules, but ERISA adopted a comprehensive regime for all plans as to participation, vesting, funding, prohibited transactions, and other matters. The owner-employee rules deal with these same matters and are no longer needed. If these rules cannot be entirely eliminated, at the very least a more reasonable set of rules for owner-employees of all businesses should be developed, whether incorporated or not, whether personal service or capital intensive.

The American Bar Association strongly opposes section 6 of the bill, which would extend all of the existing discriminations against the self-employed to shareholder-employees of a new class of corporations—personal service corporations. This does not achieve equality of treatment; it creates greater inequality. The correct solution is instead to eliminate all of the existing discrimination against the self-employed. Although the use of professional corporations has resulted in an increase in qualified retirement plan benefits for professional persons, those corporations have also produced substantial benefits and coverage for a large number of their nonprofessional lower paid employees. This is clearly the case in my own law firm. This greatly fosters the national policy objective of increasing the coverage of the private pension system. Contributions and benefits for shareholder-employees of personal service corporations are limited by existing law in the same way that contributions and benefits are limited for all other employees covered by qualified plans, including employees who are owners of business. Further limitations solely on self-employed persons and shareholder-employees of personal service corporations are not necessary or justified.

If, contrary to our position, rules beyond those provided generally for qualified plans in ERISA are considered necessary for employees who are owners of the business, as I have previously suggested, a more reasonable and uniform set of such rules should be developed for all such owners-employees—excluding employees who are shareholders holding a small interest in a publicly held corporation—In no event, however, should any such rules set a limit on contributions and benefits for owner-employees which is lower than the limit for employees in general.

Section 7 of the bill would impose uniform nondiscrimination rules upon statutory fringe benefit plans. Section 7 would not create any discrimination against the self-employed and accordingly, so far as it presently goes, we take no position on it. We strongly urge, however, that its objective of greater equality of treatment be extended by removing the existing discrimination whereby these statutory fringe benefits are for the most part denied to self-employed persons. There is no justification for denying the same income tax treatment to self-employed persons that is provided to corporate employees in general. The form of business organization has no relationship to the validity of these statutory fringe benefits. Congress may wish to reexamine the proper scope of each of these statutory benefits, but no rational tax policy can allow their availability to turn upon whether the individual is self-employed as opposed to being a corporate employee.

Thank you.

[The prepared statement and additional material follow:]

STATEMENT OF JOHN S. NOLAN, CHAIRMAN, SECTION OF TAXATION ON BEHALF OF THE AMERICAN BAR ASSOCIATION

I am John S. Nolan, Chairman of the Section of Taxation of the American Bar Association. I am accompanied by James T. O'Hara, Chairman of the Legislative Subcommittee of the Standing Committee on Retirement of Lawyers of the Association. We speak today for the entire American Bar Association, some 275,000 lawyers throughout the United States, with respect to H.R. 6410, the Pension Equity Act of 1982.

GENERAL CONSIDERATIONS

This is an extraordinarily important bill. It would require major revisions in virtually every pension and profit-sharing plan in the United States, only eight years after the Employee Retirement Income Security Act of 1974, ERISA, required similar revisions. The need for, and cost of, many of these proposed revisions, and their effect upon the continuation of existing employee retirement plans and the incentive to create new ones, must be very carefully considered by this Committee.

The issues addressed in this bill are so important to the health of the private pension system in the United States that they require much more study and debate. We strongly urge this committee not to take action on this bill as hastily as is suggested by the unexpected early scheduling of this hearing, only twenty days after the bill was introduced and eight business days after it became publicly available. Much too much is at stake in terms of sound economic and social policy in the United States.

The private pension system is the key to inducing a higher savings rate in the United States, and thus to increased capital formation. Additional funds contributed to private retirement plans in lieu of current wage and salary increases tend to create new savings that would not otherwise occur. It is not merely a shifting of savings from one form to another, which is all that principally results from most other tax provisions designed as savings incentives. From a social policy standpoint, private pension savings relieve major pressures for increased social security taxes and benefits, increase employees' interest in their work and their employer companies, and foster a healthy sense of independence and security. The massive pool of savings represented by private pension plans is allocated by the market to its most productive uses, including risk-taking, sponsorship of healthy and growing industry, and investment in research and new technology. This Committee must be certain that the several provisions of this bill each support and enhance these effects.

The American Bar Association strongly believes that a critical element in revising our private pension system to achieve these economic and social policy objectives is equality of treatment of the self-employed. This position is reflected in a formal policy statement of the Association which has been in effect since 1963. That position was, in effect, endorsed by President Carter's Commission on Pension Policy in its final report, and it was more recently endorsed by the New York State Bar Association in its comprehensive analysis of the tax treatment of professional corporations. H.R. 6410 takes some steps in that direction but then unfortunately fails to complete those steps and actually takes some steps backward that will increase the existing discrimination against the self-employed. This is not only unfair; it is unsound tax, economic, and social policy.

The equality of treatment of the sef-employed espoused by the American Bar Association reflects a broader policy that tax provisions governing the private pension system and statutory fringe benefit plans should not discriminate to any extent based on the form of organization of the business. Further, they should apply even-handedly with respect to all employees similarly situated, whether employed by capital-intensive businesses or service-intensive businesses, whether large or small business is involved.

Equity of treatment of private pension plan participants, regardless of the form of business organization, was substantially advanced in the Employee Retirement Income Security Act of 1974 (ERTSA) and again in the Economic Recovery Tax Act of 1981 (ERISA). As previously stated, H.R. 6410 in some respects continues that sound policy but regrettably falls far short of carrying out its announced objectives. In fact, in other respects it creates important new discriminations against self-employed persons and against shareholder-employees of a new class of corporations, personal service corporations. This is completely unnecessary. All existing discriminations and these proposed new discriminations could be completely avoided simply by treating all self-employed persons and corporate employees similarly situated by the same rules, regardless of the form of business organization, the type of business conducted, or the size of the business organization.

Against this background and these vital policy considerations, the provisions of H.R. 6410 may be tested.

SECTIONS 2 AND 8: CONTRIBUTION AND BENEFIT LIMITS AND ESTATE TAX EXCLUSIONS

Section 2 of the bill would reduce the existing dollar limitations on contributions and benefits; eliminate the annual cost-of-living adjustment to these dollar limits; reduce the maximum combined limitation from 140 percent to 100 percent; require actuarial reduction for benefits commencing before age 65; and require that certain post-retirement medical benefits be taken into account in applying the dollar benefit limitation. Section 8 of the bill would limit the estate tax exclusion for employer-paid benefits to $500,000.

Section 2 and 8 would apply even-handedly with respect to all participants in qualified plans, although they present other, perhaps more fundamental, issues of private pension policy that must be considered by this Committee. We take no position on these other issues except to observe that the American Bar Association also has formally adopted a policy favoring indexing of fixed dollar amounts within the Internal Revenue Code. The particular cost-of-living adjustment formula presently in the Code for the dollar contribution and benefit limitations for qualified retirement plans may be too generous and thus may require reconsideration. For example, the President's Commission on Pension Policy considered a separate cost-of-living index for retirees. Such index, if developed, may be a more appropriate standard to apply than the existing adjustment provision. It seems unwise, however, completely to repeal any such adjustment factor. The net result of doing so will be to impose a gradually reducing set of limits as annual inflation occurs, putting constant pressure on Congress to increase such limits. Equity, simplification, and administrability are served by fixed rules which provide a long-term planning framework for business.

SECTION 3: LOANS TO PLAN PARTICIPANTS

Section 3 of the bill would, in effect, prohibit loans by any qualified plan to "key employees", defined as officers, employees with more than 5 percent ownership of the employer, or persons within the highest-paid 15 percent of the employees. While this provision does not discriminate on the basis of form of organization, and applies equally to key employees of all employers regardless of the type or size of the business, it does create a new form of discrimination. Key employees are treated differently from other employees without clear justification for doing so. It might be sound pension policy generally to restrict loans by plans to all employees, in order to assure the funding of future benefits for retirement purposes, but still to permit loans for certain other purposes, for example, to be used for the purchase of a principal residence or to relieve economic hardship. Surely, however, such restrictions are as appropriate for lower-paid as for higher-paid employees. This matter deserves much more careful consideration.

SECTION 5: SELF-EMPLOYED PLANS

The American Bar Association strongly supports the increase in the limit on deductible contributions to self-employed plans to $30,000. The increase, however, is illusory in practical effect because of the failure to eliminate the $200,000 limit on maximum earnings which may be taken into account or to increase that amount to $400,000. A plan including a self-employed person would be required to provide for contributions at a rate of 15 percent of compensation or higher for all participants, including all common law employees, for the self-employed participants to reach this new limit. This would be an unreasonably high contribution rate.

This same issue arose in the Economic Recovery Tax Act of 1981 when an increase in the limit on deductible contributions by self-employed persons from $7,500 to $15,000 was adopted. After careful consideration, Congress at that time consistently increased the maximum earnings that could be taken into account from $100,000 to $200,000 so long as contributions at a rate of at least 7.5 percent were made for all employees participating in the plan. At the very least, the same type of consistent change should be made in section 5 of this bill. A more ideal solution would be to remove any such special limitation and treat self-employed persons in the same manner as employees of corporations in general.

The new $30,000 limit should also be indexed for cost-of-living changes to the same extent as the limitations on contributions and benefits for corporate plans generally (see supra, pp. 4–5).

We also strongly urge that the special limitations on defined benefit plans for self-employed persons in § 401(j) of the Code be eliminated. These rules are designed to prevent self-employed persons from taking past service into account in adopting a qualified plan, but no such limitations are imposed upon employees of corporations in general. The need and justification for such special limitation is highly questionable, and in any event there is no reason to single out self-employed persons, or self-employed persons and owner-employees of personal service corporations (as section 6 of the bill would do), for such discriminatory treatment.

These special limitations in § 401(j) discourage the creation of the healthiest form of pension plan from an economic and social policy standpoint—the defined benefit pension plan. Self-employed persons should instead be encouraged to adopt such plans for themselves and their employees on a non-discriminatory basis. The increase in the contribution limit to $30,000, if made more effective as suggested above, would make the tax incentive for a non-discriminatory retirement plan sufficiently great that self-employed persons would not defer the adoption of plans until their later years simply to avoid coverage of their common law employees during the interim years. In adopting a plan, the self-employed person would be required by the non-discrimination rules to provide past service credit for common law employees as well, thus fostering the economic and social policy goals achieved by qualified plans.

The time has come to focus upon the forest and not the trees. If some few self-employed persons are enabled to achieve substantial tax deferral for a short period of years at the price of substantial coverage of their common law employees, so be it; the country will be much the richer for it.

We strongly oppose extension of the special rules applicable to owner-employees under existing law to all self-employed persons. Prior to the Employee Retirement Income Security Act of 1974 (ERISA), there was justification for these rules because the Internal Revenue Code lacked adequate provisions to prevent self-dealing and the undue weighting of benefits in favor of owner-employees. ERISA drastically changed that condition, however, by adopting comprehensive rules for all qualified plans as to participation, vesting, funding, prohibited transactions (such as self-dealing), and other matters. There is no longer any need or justification for the owner-employee rules, which simply apply somewhat harsher rules in these areas to self-employed persons who are also owner-employees (10 percent or more owners of the business).

H.R. 6410 moves in precisely the wrong direction in extending these discriminatory rules to all self-employed persons. The correct answer is to eliminate these rules entirely. If, for any reason, this is not done, at the very least a more reasonable set of rules for owner-employees of all businesses should be developed, whether incorporated or not, whether personal service or capital-intensive (see supra, p. 10–11).

The time for quick-fixes and compromises should end; if this bill is indeed to be the Pension *Equity* Act of 1982, the existing, unjustified discrimination against the self-employed should be ended, and it certainly should not be extended.

SECTION 6: PERSONAL SERVICE CORPORATIONS

The American Bar Association strongly opposes section 6 of the bill, which would extend all of the discriminations against the self-employed to shareholder-employees of a new class of corporations—personal service corporations. This does not achieve equality of treatment; it creates greater inequality. The correct solution, as previously stated, is to eliminate the existing discriminatory treatment of the self-employed.

The reported instances of "abuse" in this area are overstated. Although the use of professional corporations has resulted in an increase in qualified retirement plan benefits for profesional persons, those corporations have also produced substantial benefits and coverage for a large number of nonprofessional lower-paid individuals employed by them. This has fostered the national policy objective of increasing the coverage of the private pension system. The contributions and benefits for shareholder-employees are limited to the same extent as contributions and benefits are limited for all other employees covered by qualified plans, including employees who are owners of the business. Further limitations solely on self-employed persons and shareholder-employees of "personal service corporations" are not necessary or justified.

There is no rational basis for singling out "professional service corporations" for this discriminatory treatment. The term "personal service corporation" as defined in the bill is broader than the "professional corporation" form of organization in which professional persons who have incorporated have been authorized by state laws to conduct their affairs. It is an equally arbitrary classification, however, in that it includes only service businesses and only some service businesses. Why should the rules be stricter for some service businesses than for other service businesses, or for service businesses as opposed to non-service businesses? This is an invidious line of distinction.

If, contrary to our position, rules beyond those provided generally for qualified plans in ERISA are considered necessary for employees who are owners of the business, a more reasonable and uniform set of such rules should be developed for all such owner-employees (excluding employees who are shareholders holding a small interest in a publicly-held corporation). In no event should any such rules set a limit on contributions and benefits for owner-employees which is different from the limit for employees in general. Otherwise, however, such rules could be devised, if necessary, to prevent perceived abuses, but any such special rules should be developed so as simultaneously to encourage the comprehensive inclusion of the broadest possible class of employees in qualified plans. Such encouragement, and the elimination of abuses, are key objectives of this bill, and the American Bar Association supports those objectives. The bill in its present form, however, will have a very counter-productive effect of discouraging the adoption of new plans with broad employee coverage and the enrichment of benefits under existing plans.

SECTION 7: STATUTORY FRINGE BENEFITS

Section 7 of the bill seeks to impose uniform non-discrimination rules upon statutory fringe benefit plans, such as plans providing group term life insurance, disability insurance, accident and health benefits, medical expense reimbursement, prepaid legal services, van pooling benefits, educational assistance, and dependent car assistance.

Section 7 would not create discrimination against the self-employed on the basis of form of organization or type or size of business conducted. Section 7 fails, however, to correct an existing severe discrimination whereby with certain limited exceptions (such as prepaid legal service plans), these statutory fringe benefits are simply unavailable to self-employed persons. The American Bar Association's formal statement of policy specifically calls for treating the self-employed the same as all others with respect to such fringe benefit plans. There is no justification for denying the same income tax treatment to self-employed persons that is provided to corporate employees in general. The form of business organization has no relationship to the validity of these benefits. Congress may wish to reexamine the proper scope of each of these statutory benefits, but no rational tax policy can allow their availability to turn upon whether the individual is self-employed as opposed to being a corporate employee (shareholder-employee or otherwise).

OTHER COMMENTS

The American Bar Association takes no position on section 4 of the bill dealing with integration with social security.

Technical comments reflecting the views of individual members of the Association on specific provisions of the bill are being collected and may be submitted to this Committee by those individuals.

CONCLUSION

Congressman Rangel has focused attention on important questions of tax policy dealing with the private pension system in H.R. 6410. His stated major objective is to provide greater incentives for comprehensive inclusion of the broadest possible class of employees in qualified pension and statutory fringe benefit plans. The American Bar Association particularly applauds Congressman Rangel for his effort to achieve this most worthy objective. At the same time, however, we urge that this Committee move slowly and carefully to determine the extent to which the individual provisions of this bill would achieve this goal. We are concerned that some of its provisions are counter-productive in this respect.

A most important change in existing law to accomplish this major objective would be to remove all of the existing discriminations against the self-employed. These discriminations are no longer necessary in light of the comprehensive regulatory framework for qualified plans adopted in ERISA, and particularly as that framework would be tightened elsewhere in this bill. Section 5(a) of the bill moves importantly toward equal treatment of the self-employed, but unfortunately it is seriously incomplete. Further, the major objective of the bill to extend the coverage of the private pension system would be substantially hindered by other provisions of section 5 extending new discriminations against self-employed persons, and by section 6 of this bill extending the discriminations against the self-employed to professional service corporations.

There is no rational tax policy justifiying discrimination based on the form of business organization or the type or size of business conducted. This discrimination stands in the way of greater accomplishment of the fundamental economic and social policies that are served by the private pension system. It should be ended. The American Bar Association strongly recommends that it be ended. H.R. 6410 presents a golden opportunity to do so; it should not be wasted.

SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

INDIVIDUAL TECHNICAL COMMENTS ON H.R. 6410—THE PENSION EQUITY ACT OF 1982

The following comments are the individual views of members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or of the Section of Taxation.

Lower Limits Where Individual is Covered by Both Defined Benefit Plan and Defined Contribution Plan (Section 2(c) of the Bill).

Under this provision, the aggregate limit applied to a participant covered by both a defined contribution and a defined benefit plan would be reduced from 140 percent to 100 percent of the separate limits.

New Section 415(e)(3)(A) defines the defined contribution fraction as the greater of the annual fraction or the cumulative fraction. The annual fraction is defined in Section 415(e)(3)(B) as a fraction whose numerator is the annual addition to the participant's account for the year, and whose denominator is the maximum amount of the annual addition to such account which could have been made under subsection (c) for such year. Therefore, if the maximum addition were contributed in any year, the defined contribution fraction in that year would be 1.0, whether or not any contributions had been made to the account in prior years. The cumulative fraction is defined in section 415(b)(3)(C) as the average of the defined contribution fractions (determined without regard to subparagraph (C)) for such year and for each prior year of service with the employer to which Section 415 applied.

Under the law as now in effect, the definition of defined contribution plan fraction is similar to the proposed definition of cumulative fraction. As a result, the operation of the defined contribution plan fraction has allowed a corporation to take prior years into account in determining limits under the 1.4 rule for additions to defined contribution plans. The contribution in any year has, of course, been subject to the annual addition limit Section 415(c) (i.e., 25 percent of compensation of $25,000 adjusted for changes in the cost of living). That has not meant, however, that the annual addition could only be a portion of the Section 415(c) limit if the defined benefit plan fraction was more than .4. In applying the defined contribution plan fraction, the underlying concept has been that that fraction measures the extent to which the corporation has used the available limits on annual additions.

For example, if a defined benefit plan provides a benefit equal to .8 of the maximum benefit allowable under Section 415(b), a defined contribution plan, even if adopted at a later date, could over a period of time reach a defined contribution plan fraction of .6, subject always to the limit on annual additions under Section

415(c). Thus, in the early years of defined contribution plans, the defined contribution plan fraction for long service employees would be very small, even if the contributions in those years were 100 percent of the amount allowed under the annual additional rules, provided that no contributions (or small contributions) had been made for prior years. In such case, the denominator of the defined contribution plan fraction would be a large amount, and therefore the value of the fraction would be small.

The defined benefit plan fraction for any participant can be 1.0 even if the plan is adopted late in the participant's working career. This is not possible in the case of a defined contribution plan under present law. Since it is not possible to make a contribution in any year in excess of the annual limit, the fraction in such a case will always be less than 1.0. To a limited extent, the defined contribution plan fraction has made it possible, within the boundaries of the 1.4 rule, to make up for the fact that contributions were not made in prior years. This flexibility seems desirable.

Under proposed new Section 415(e)(3), the defined contribution fraction would never be less than the annual fraction. Accordingly, if the defined benefit fraction were .8, the employer could not contribute to a defined contribution plan more than 20 percent of the annual addition limit (i.e., $6,000, which is 20 percent of the annual addition limit of $30,000). Under the policy contained in present law, a contribution of $30,000 could be made if that amount did not exceed 20 percent of the aggregate of the limit for the current year and for prior years, and no contributions had been made in those years.

The effect of the proposed change is to restrict significantly the use of defined contribution plans when a corporation also maintains a defined benefit plan. Since the effect of the new provision could, to a large extent, be avoided by establishing a defined contribution plan in the early years, the provision does not appear to reflect any clear policy and, in our judgment, should be reexamined.

There is also uncertainty as to the meaning of certain provisions of the Bill relating to the 1.0 rule. For example, the language "for each prior year of service with the employee to which this section applied", contained in proposed Section 415(e)(3)(C), would change the corresponding provision of Section 415(e)(3)(D), as now in effect. If the quoted words mean that experience before 1976 would not be taken into account, the new provision might in some cases result in a lower limit. Why this result would be desirable is not clear.

In addition, proposed Section 415(e)(4)(B) provides that the defined contribution fraction for each year ending on or before December 31, 1983 is to be appropriately reduced to reflect the fact that the limitation for such year was 1.4 instead of 1.0. This provision, which applies in computing the cumulative fraction, may mean that the defined contribution plan fraction for each year ending on or before December 31, 1983 is to be reduced by .4, but not below 0. Some such adjustment seems necessary in applying the proposed new provisions, but it is beleived that the statutory language should be clarified.

SOCIAL SECURITY INTEGRATION (SECTION 4 OF THE BILL)

Section 4 of the Bill would make fundamental changes to the rules under existing law whereby qualified pension and profit sharing plans take into account employer provided Social Security benefits in determining the benefits employees are entitled to under the private plan.

The experts in this field and the sponsors of private plans have simply not had time to analyze these provisions. It is the Section of Taxation's recommendation, that the Committee delay its consideration of Section 4 of H.R. 6410 until such time as the public has had sufficient time to carefully analyze its proposals and to present the committee with its conclusions.

The process of "integrating" Social Security benefits with private pension benefits is generally one of the most important factors in determining an employer's cost of providing benefits under a private plan. The wide impact and sensitivity of changes in the integration rules became apparent when ERISA was proceeding through the legislative process in 1974. One of ERISA's predecessor bills, H.R. 2 (93d Congress, 2d Session), included amendments that would have restricted the ability of qualified plans to take into account employer contributions toward increases in Social Security benefit levels after 1971. H.R. Rep. No. 1280, 93d Cong., 2d Sess. 130–31 (1974). These proposals were removed from H.R. 2 by a concurrent resolution adopted immediately following the filling of the conference report on H.R. 2 because of the immediate expression of concern by the public regarding the impact of the provisions. See 120 Cong. Rec. 29, 196 (1974) reprinted in 3 Legislative History of ERISA 4656, 4682–83 (1976). This experience indicates that legislation in this area should be subjected to the most thorough and complete analysis and commentary by the public and private experts in the pension area. The short period of time between the publication of the Bill on May 25, 1982 and the scheduled hearings on June 8, 1982 has not allowed for this preparation. Either Section 4 of the Bill should be deleted, or further hearings should be scheduled at a future date.

EFFECTIVE DATES

General Comments.—H.R. 6410 provides for effective dates which are too early and too complex. For example, the effective date provisions apply variously to:

(1) Years ending after a particular date; (2) years beginning after a particular date; (3) plan years ending after a particular date; (4) plan years beginning after a particular date; (5) taxable years ending after a particular date; (6) taxable years beginning after a particular date; (7) transactions after May 19, 1982; and (8) years ending after the date of enactment.

The complex ERISA plan amendment process demonstrated that early and different effective date provisions create mass confusion, misunderstanding and non-compliance. The Internal Revenue Service should be given ample time to issue the necessary governing guidelines, regulations and procedures, and thereafter plan sponsors should be accorded sufficient time to implement the necessary plan changes. Simply stated, the effective date provisions of H.R. 6410 are exceedingly deficient—in most cases they are too early, in other cases they are confusing and unnecessarily complex. All of the effective date provisions should be deferred and simplified.

Lower Contribution and Benefit Limits (Section 2 of the Bill).—The new rules under Code section 415 providing for lower contribution and benefit limits for qualified plans are effective at different times. For new plans, the new rules apply to years ending after the date of enactment; for existing plans some of the new rules are effective for years ending after December 31, 1983 and some (the repeal of cost of living adjustments) are effective sooner. These multiple effective dates will undoubtedly engender confusion and inadvertent non-compliance. There should essentially be a single effective date for the new rules on limits, as there was when section 415 was enacted as part of ERISA. Then, the overall effective date was for years beginning (not ending, as with the current proposals) after 1975.

Even though Section 415, as originally enacted, was generally effective for plan years beginning after 1975, final regulations were not adopted until 1981 and plans do not have to be amended to conform with these regulations for several more years in some cases. Almost every pension plan subject to ERISA will, however, have to be amended to conform with these new rules by the deadline. This may be the third, fourth, or later round of ERISA amendments. To impose these complex effective dates on another round of industry-wide amendments is unreasonable and unfair.

Loans to Certain Participants (Section 3 of the Bill).—It is unreasonable that the changes regarding loans are effective for loans made after May 19, 1982. First, many plans sponsors with loan provisions in their plans have no doubt not yet even heard about this proposed legislation and thus cannot be deemed to be on "notice". Second, such an effective date would be a breach of promise to many thousands of employees who have elected to make contributions to a cash or deferred plan under Code section 401(k) under the assumption that they could borrow from such a plan in the eventuality of need. When Congress enacted a prohibition against loans from H.R. 10 plans for all self-employed individuals as part of ERTA, the effective date adopted (i.e., loans made after 1981) gave affected participants a reasonable time within which to exercise whatever loan rights they had after the passage of the legislation. A similar adjustment period should be provided in this situation.

Social Security Integration Rules (Section 4 of the Bill).—The new rules will apply to plan years ending after December 31, 1983, except that, in the case of a defined benefit plan, the new rules will not apply to any individual who was a participant in such plan before January 1, 1984. A much longer transition period is needed. As anyone familiar with the current guidelines will attest, the integration of Social Security benefits with qualified employee benefit plans is a detailed, complex matter involving many legal, actuarial and practical considerations. Promulgation of new guidelines will necessitate careful study over an extended period of time. After such rules are developed and published, it will take some time for plan sponsors to decide how to redesign their plans to comply with the new rules. Application of these rules to years ending after December 31, 1983 does not permit sufficient time for these complex adjustments.

Self-Employed Limits and Rules Changes (Section 5 of the Bill).—Here again there are differing effective dates applicable to the changes. For the increases in the limitations, the new provisions are to apply to *taxable years* beginning after 1983 while the extension of certain requirements applicable to plans covering any owner-employee to plans covering any self-employed person are to apply to *plan years ending* after 1983. These differing effective dates introduce needless complexity and confusion.

Changes Affecting Personal Service Corporations (Section 6 of the Bill).—These new rules are effective for years ending after 1983. Does this mean plan years or taxable years? We do not know. This must be clarified.

Changes in Statutory Fringe Benefit Plans (Section 7 of the Bill).—These extensive, complex rules are to apply to plan years ending after 1983. Since plan years starting as early as February 1, 1983 will be affected under this proposal, insufficient time is allowed for the implementing regulations to be drafted and adopted in final form. A later effective date is necessary.

Changes in Section 2039 (Section 8 of the Bill).—These changes are effective for estates of decedents dying after 1982. This does not allow sufficient time between enactment (later this year) and the effective date to permit review and revision of estate plans which have relied upon the unlimited estate tax exclusion of present law.

CONCLUSION

The effective dates in the Bill are too early and too complex.

For new plans the new rules of Section 2 of the Bill should apply to years beginning after the date of enactment, instead of years ending after date of enactment. With respect to existing plans the rules should not apply to years beginning before July 1, 1983.

Section 3 of the Bill should not be effective with respect to loans made before December 31, 1982.

Since Sections 4 through 7 of the Bill are not generally perceived as sources of increased revenues, a later effective date should be provided which will apply uniformly to these Sections of the Bill. These provisions should apply to years beginning after December 31, 1983.

Section 8 of the Bill should not apply to decedents dying before June 30, 1983.

Chairman **ROSTENKOWSKI**. Thank you.

Mr. Diamond, you may proceed.

STATEMENT OF LOUIS H. DIAMOND, ESQ., FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG & CASEY

Mr. **DIAMOND**. My name is Louis Diamond. I am a tax partner in the law firm of Finley, Kumble, Wagner, Heine, Underberg & Casey. I am here today representing that firm which has more than 300 clients for whom I have designed qualified deferred compensation plans. I will submit my written comments for the record.

Chairman **ROSTENKOWSKI**. Without objection, every member of the panel's full testimony will be included in the record.

Mr. **DIAMOND**. Initially I would like to express my general opposition to H.R. 6410 as being inappropriate, especially at this time. I want to focus particularly on section 6, which would single out for special discriminatory treatment a segment of our economy, professional service, which would then be denied full access to qualified deferred compensation. I think that this is inappropriate and not justified. Some years ago, professionals were not enabled to use the corporate form of operation largely due to self-imposed inhibitions. Over the years, all professional associations have withdrawn these inhibitions, as have all 50 States, and, for more than 10 years now, professionals have had full access to the type of planning, in terms of access to legal entities, that all firms have had regardless of the manner in which they create their active income. The nature of active income as to all businesses should be immaterial when it comes to the design of qualified deferred compensation arrangements. It is inappropriate to single out a particular segment of the economy and deny it access to the same qualified deferred compensation otherwise available to all other segments of the economy.

I would next like to focus on the maximum contribution and benefit limitations. These were reasonable in 1974, and the only thing that has happened in the interim is the impact of inflation through a cost-of-living allowance. If these limits were reasonable in 1974, they are equally reasonable now, because we are talking about purchasing power that equates to the purchasing power as it was in 1974.

I am particularly concerned with the elimination of COLA in the area of defined benefit plans. The whole concept of defined benefit plans is dependent upon a COLA. It is amazing what relatively low levels of compensation, when projected into the future with a salary scale that is a combination of inflation and merit increases, will end up exceeding a $90,000 limit. For sure, a 35-year-old employee earning $35,000, projected until an age 65 retirement, would greatly exceed that limit.

I would like to suggest that our actuarial brethren when determining how the defined benefit plans are to be funded, take into account inflation and project the funding today, while funding is available, for whatever benefit is projected to be due in the future using reasonable estimates. If we have a lid and say we will periodically review that lid and lift it if it is meritorious, then we are running in the face of the whole concept of defined benefit plans. Because 10 or 15 years from now if we lift a $90,000 lid to $110,000, we would have too few years remaining to fund that increased pension availability for those people prevented from funding for a normal pension due to a lid that is inflexible.

I submit, in the area of qualified deferred compensation, to deal in today's dollars when talking about tomorrow's retirement is going to be a cruel hoax, because we are going to end up funding an inadequate retirement.

Let me move to the revenue estimates. I understand that they are nominal through 1983, $19 million; in 1984, $0.6 billion; and thereafter approximately $1 billion a year. I question that as to 1982 and 1983, because if this bill becomes law there will be a tremendous amount of moneys expended in amending all of these plans. Those moneys will be deductible, and we will actually have a decrease in revenue. As far as the residue of the projections, it would have to have been projected that existing plans are going to be downgraded, terminated, or not adopted in the first place. I do not think that is the way we should be going. We need the plans now. We need the retirement for rank and file employees. We need the funds these plans create to get us out of our economic doldrums of today.

As my last point, I request that this process be slowed down. It is going at breakneck speed. We are dealing with legislation of great magnitude, and we need more time to consider and review it. I would certainly think that everybody that is going to be affected should have an opportunity to reflect on this; and I suggest that we take that into account and slow this process down.

Thank you.

[The prepared statement follows:]

STATEMENT OF LOUIS H. DIAMOND, ESQUIRE, FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG & CASEY

Mr. Chairman and distinguished members of the Ways and Means Committee, my name is Louis H. Diamond. I am a tax partner in the Washington, D.C., office of the law firm of Finley, Kumble, Wagner, Heine, Underberg & Casey.

A major portion of my 20 years practicing tax law has been spent in the pension planning area. I have witnessed, from a practitioner's standpoint, the impact that a progression of necessary and important pre- and post-ERISA changes have had on the private pension system. Our office represents in excess of 300 clients who use various aspects of our private qualified deferred compensation system. Those clients are engaged in the full spectrum of business endeavors.

I have lectured nationally on the subject of qualified deferred compensation on behalf of the American Law Institute—American Bar Association, and the Southern and Southwestern Tax Institutes.

I am a former Adjunct Professor of Law at the Georgetown University Law Center where I instructed law students on various aspects of tax and pension planning, and I am a member of the ABA Section of Taxation's Committee on Employee Benefits.

I thank the Committee for assembling such a qualified panel in an effort to thoroughly understand the ramifications that these changes would have on the private pension system. The pressures on Congress to raise a significant amount of revenue to strengthen the economic vitality of our country are intense. Since this Committee has jurisdiction over both the major spending programs and the revenue-raising sources of government, the pressure on you is particularly strong. While this bill is projected to raise revenues, we question the accuracy of the calculation, and suggest that any revenues actually collected would be at a social cost that this Committee may well find unacceptable for the reasons summarized below:

1. The plan downgrading and terminations that would result from the lowering of contribution and benefit limits will drain capital from the private pension system at a time when the system is in the process of becoming a major source of the investment capital essential to our economic recovery.
2. H.R. 6410 will seriously disrupt the private pension system and cause massive plan terminations at a time when the future viability of the Social Security system is in doubt.
3. Persons employed in the professional service segment of our economy are singled out for special discriminatory treatment under Sections 5 and 6 of this bill.
4. Reduction in the maximum contribution and benefit limitations and the elimination of a cost-of-living adjustment ignore the original legislative intent of Congress to "assure the reasonable needs of individuals for a dignified level of retirement income."
5. Existing law is sufficient to properly control participant loans from qualified deferred compensation plans.
6. H.R. 6410's revenue gain projections are excessive and misleading.

The private pension system is a major source of the investment capital essential to our economic recovery. Passage of H.R. 6410 would severely inhibit its continued growth.—Many of H.R. 6410's provisions will mandate smaller employer contributions and, therefore, the private pension system will produce less investment capital. Additionally, many employers would choose to terminate their plans rather than downgrade them to the extent required by this proposed legislation. These terminations would result in a debilitating capital drain from the private pension system which would be felt throughout the economy now when we can least afford it.

H.R. 6410 will seriously disrupt the private pension system at a time when the future viability of the Social Security system is in doubt.—The private pension system needs more time to assimilate the major changes already enacted during the last eight years. ERISA constituted a complete revamping of the pension ground rules and was the culmination of many years of study by the labor and tax committees of both Houses of Congress and at least three administrations. In almost every year since the passage of ERISA, additional pension legislation has ensured. These major legislative changes have necessitated the continuous reworking of the language in each individual pension plan. Drafting changes are time-consuming, expensive to plan owners, and confusing to employers and employees alike. In the past, many employers have chosen to terminate existing plans rather than to redraft or amend their plans to comply with these frequent legislative changes. Further changes, especially those which would downgrade benefit entitlements, can be expected to cause massive plan terminations at this most inopportune time when the very viability of the Social Security system is in doubt.

Persons employed in the professional service segment of our economy are singled out for special discriminatory treatment under Sections 5 and 6 of H.R. 6410.— The nature of the services rendered to produce a corporate employer's income should not be relevant when the issue involved is the permissible scope of qualified deferred compensation which that employer is entitled to provide for its employees. The employees of an accounting firm should be treated no differently than the employees of a manufacturing firm. Yet, by applying H.R. 10 restrictions to professional service corporations, as the bill proposes, persons employed in the professional services will, almost assuredly, receive benefits which are considerably less than those available to persons (including professionals) employed in other segments of our economy. You must recognize that a lowering of contribution and benefit levels will affect all plan participants, not just those who are highly paid. If an owner-employee's annual contribution is reduced, the contribution his corporate employer makes on behalf of all other employees is going to be reduced to the same, or even to a greater, degree. This occurs because the contribution on behalf of the non-owner employee can be expected to be the same percentage of that employee's annual salary as the contribution on behalf of the owner-employee is to the owner-employee's annual salary. If the owner-employee is limited to a lesser contribution, it can only be anticipated that the non-owner employee will also receive commensurately less. The following simplified example illustrates this point:

1. Firm I: Professional Service Corporation—

Owner-employee A—$100,000/yr. salary; 15,000 maximum contribution (15 percent of salary).

Employee A—$20,000/yr. salary; 3,000 contribution (15 percent of salary).

2. Firm II: Corporation—

Owner-employee B—$100,000/yr. salary; 25,000 contribution (25 percent of salary).

Employee B—$20,000/yr. salary; 5,000 contribution (25 percent of salary).

3. In this example, a professional service corporation employee would receive $2,000 less than a comparable corporate employee when the only material difference in their position is that Firm I produces services rather than products. We submit that this is not a proper ground for distinguishing between otherwise analogous citizens.

Reduction in the maximum contribution and benefit limitations and the elimination of the cost-of-living (COLA) adjustment ignores the original legislative intent of Congress with respect to these limitations.—In 1974, an annual individual contribution limit of $25,000 and benefit limit of $75,000 was enacted as a level that would assure the "reasonable needs of individuals for a dignified level of retirement income" (H. Rept. 93-807, 93rd Cong., 2nd Session, February 21, 1974, page 112). The Committee also recognized the importance of adequate tax incentives in "creating a strong pension system." (*Id.*) And, "to prevent the erosion of the value of an employee's pension due to inflation," a cost-of-living adjustment was attached to these limitations (Id., at 119). Congress would reverse these desirable legislative goals if it scales back the inflation-adjusted pension limits and abolishes all future cost-of-living adjustments. In future years, retirees would be forced to support tomorrow's standard of living with yesterday's dollars.

Moreover, these proposed changes are inconsistent with the treatment accorded our public retirement system. Social Security benefits are increased by a COLA adjustment on the average of twice a year. The federal retirement system receives similar COLA treatment. We submit that there is no justification for according lesser treatment to the private retirement system than that accorded to its public counterpart.

Existing law is sufficient to properly control participant loans from qualified deferred compensation plans.—Under Section 4975(d)(1) of the Internal Revenue Code of 1954, participant loans from qualified deferred compensation plans must be of limited duration, adequately secured, bear a going rate of interest, and be kept in perspective in relation to other trust fund investments. This statutory protection makes it appropriate to allow participants to borrow from the fund created in support of their qualified retirement plan.

Especially in this current tight credit market, it is particularly appropriate and sensible to provide plan participants with a source of capital to finance things such as home purchases or the education of their children. These borrowers pay a market rate of interest at least equivalent to what the fund would receive on a comparable prudent investment. The loans must be fully secured and the opportunity to borrow must be extended to all plan participants equally.

H.R. 6410 proposes to withdraw these loan opportunities only from "key employees"—while retaining their availability to other employees. What the bill fails to recognize, however, is that since key employees design these plans, no provision permitting employee loans will be included in the plan unless key employees are entitled to participate.

H.R. 6410's revenue gain projections are excessive and misleading.—The revenue projections from H.R. 6410 are, we believe, overstated. First of all, they must, of necessity, be premised upon reduced contributions predicated upon plans being amended, terminated or not adopted in the first place—an inappropriate revenue source in any event. If this bill were to produce "equity," as its name suggests, plan contributions would increase, not decrease, with a resulting revenue loss rather than a revenue gain.

Moreover, it is unfortunate, but reasonably predictable, that a large portion of funds diverted from employee plans (e.g., the $12,000 [$10,000 + $2,000] of contribution reduction in the example on page 6) will end up being spent on relatively nonproductive tax shelters rather than be allowed to remain as increased taxable income. And, it must be recognized that, while additional revenues are not even projected until 1984, passage of H.R. 6410 would necessitate plan amendments and terminations during 1982 and 1983, generating wasteful, but deductible, legal, actuarial, and accounting fees.

In conclusion, we submit that H.R. 6410 should not now be enacted into law.

Chairman ROSTENKOWSKI. Mr. Boynton, you may proceed.

STATEMENT OF EDWIN F. BOYNTON, CONSULTING ACTUARY, THE WYATT CO., REPRESENTING THE NATIONAL SMALL BUSINESS ASSOCIATION

Mr. BOYNTON. My name is Edwin Boynton. I have been a consulting actuary with the Wyatt Co. for 25 years. I speak on behalf of the National Small Business Association, which is a multiindustry trade association representing approximately 50,000 small business firms nationwide.

We have prepared a rather extensive written statement which touches on most of the major aspects of the bill.

In introducing the bill, Congressman Rangel stated:

> A major objective of the bill is to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans.

Unfortunately, we believe that the effect of the bill will be exactly the opposite. The bill will not only reduce incentives for both small businesses and large businesses to adopt or expand qualified pension or defined contribution plans, but it will undoubtedly lead to the termination or curtailment of many existing plans.

While the bill may appear to achieve its second objective of reducing the "excessively high tax limits on tax-free accumulations under corporate pension plans," the longer term effect will be to shift a portion of the total compensation package for management employees from funded, qualified plans to unfunded, nonqualified arrangements, which reduces substantially the benefit security of such programs. This shifting of emphasis from qualified plans to nonqualified arrangements will have an obviously detrimental effect by reducing or eliminating qualified plan coverage for rank and file employees.

Also in the longer range, the lack of cost-of-living adjustments in the specified dollar limits for benefits or contributions will ultimately affect most employees, not just management employees. Thus, if inflation continues even at modest levels, the restrictions in the bill will ultimately impact on all levels of employees presently covered by such plans.

The effect of the bill may be equally as devastating on the growth of defined benefit plans as ERISA was, which also was enacted with high hopes of strengthening and encouraging the growth of private pension plans. However, one effect of ERISA can be measured by the fact that approximately 30,000 defined benefit pension plans have terminated since 1975, as contrasted with an average of about 1,000 per year for the years preceding ERISA. Those 30,000 terminated defined benefit plans compare with approximately 138,000 defined benefit plans reported by IRS at the end of 1980, so that the number of terminated defined benefit plans since ERISA is equal to approximately 22 percent of the universe of such plans now in existence. The effects of this bill may be just as harmful as ERISA, if not more so, in terms of the future expansion of qualified plans.

As an actuary I have had considerable experience in dealing with the civil service retirement system, having been on the board of actuaries for the system for approximately 13 years and chairman for the last several years. With that background, I cannot help but compare the level of retirement benefits provided to the persons responsible for drafting the bill with the impact on those it will affect. Government employees, including Congress and its staff, are covered by what can only be described as an exceedingly generous retirement plan. Private industry cannot afford to provide such liberal benefits, and yet the bill is aimed at further reducing incentives for the establishment of even the modest level of plans that private industry can afford. Because of this background of working with the civil service retirement system, on many points my testimony presents comparisons between the relative level of benefits available to employees covered by the civil service retirement system and employees in private industry.

Perhaps the most serious objection to the bill is the haste with which such important issues are being presented for public discussion. Most of the issues presented in this bill were discussed over long periods of time preceding the passage of ERISA. While there are different views as to whether or not ERISA was good legislation, one can at least agree that the issues were given very serious, careful, and long consideration before enactment of the bill. The proposed bill attacks many of the issues that were discussed at great length in the consideration of ERISA and makes radical changes in them without any particular rationale to support the proposals.

The scheduling of a hearing only 20 days after the bill is introduced gives little chance for anyone to analyze fully and prepare appropriate testimony on the bill, particularly in the integration area. We hope that the committee will recognize the seriousness of the changes being proposed and will at least provide opportunity for further discussion of the bill if it continues to receive serious consideration in the future. There is concern that the provisions in this bill might be incorporated into budget-related legislation and be swept through in Congress haste to adopt a budget. This would be very unfair in view of the significant impact of the bill on thousands of pension plans all over the country.

H.R. 6410 would make drastic changes in the so-called section 415 limits of the Internal Revenue Code, which place maximum limits on the amount of benefits payable from a qualified defined benefit plan or contributions to a defined contribution plan. Specifically, it would do the following.

One, reduce the current maximum benefit payable from defined benefit plans from $136,425 for 1982 to a fixed $90,000, and similarly reduce the maximum contribution to a defined contribution plan from $45,475 to $30,000, each approximately a one-third reduction. Since the $136,425 and $45,475 represent CPI adjustments to limits of $75,000 and $25,000, respectively, in ERISA, this can be viewed as adjusting the original ERISA limits to approximately $50,000 and $16,667, respectively.

Two, eliminate a provision in the code for future cost-of-living adjustments in the revised $90,000 and $30,000 limits. The current 1982 limits were arrived at by applying annual cost-of-living adjustments to the original $75,000 and $25,000 limits in ERISA.

Three, the fixed $90,000 maximum benefit amount from a defined benefit plan would be actuarially reduced for retirement below age 65, instead of age 55 as in the current law.

Four, reduce the maximum benefits permitted to be payable from a combination of a defined benefit and defined contribution plan by reducing the composite maximum ratio from 1.4 to 1.0.

Five, make changes in the calculation of the "defined contribuion ratio" used to determine the ratio indicated in item 4 above by eliminating credit for service before the defined contribution plan went into effect.

Obviously the initial impact of these changes would be to affect only relatively highly compensated employees and reduce their prospective benefits from qualified plans. However, in future years, assuming continuing inflation without subsequent adjustment in the fixed dollar limits, the impact will affect more and more people covered by qualified plans, dipping into middle income ranks in a relatively short time, and eventually even lower.

The impact of these changes is obvious. Management people who make decisions concerning the adoption or expansion of qualified pension plans will no longer find them as attractive as before. They will be increasingly less attractive as the lack of cost-of-living adjustments in the maximum pension amounts cuts more deeply into the middle-management ranks, as it most certainly will do within a relatively few years. Certainly management will be much less inclined to make any efforts to expand pension coverage through the qualified-plan route, since benefits could not be improved for an increasing number of the employees. The overall impact is that there is a strong disincentive to future growth in defined benefit and defined contribution plans qualified under the Internal Revenue Code.

Management people do have at least one alternative, however, which is to funnel more money into nonqualified deferred compensation arrangements, or even direct compensation arrangements. This will more than likely be aimed only at top management people, the result of which will be a decline in coverage and benefits for middle and lower income people. The ERISA changes in the Internal Revenue Code make it impossible to set up a broadly based plan covering all employees without meeting the ERISA requirements, including IRS qualification and funding. To meet the requirements of ERISA, the only type of nonqualified deferred compensation arrangement which is permitted is one which covers a select group of management employees. Therefore, the effect of H.R. 6410 provisions which reduce and freeze the maximum benefit limits from qualified plans is to shift benefits toward such excess plans, which cannot by law cover middle income and lower income people. Again, the effect of the proposed legislation will be exactly the reverse of the intention.

The specific reduction in the maximum benefit or contribution limits by roughly one-third in terms of dollars appears to be very arbitrary, with no particular rationale to support it. The current 1982 limits were reached after careful study by Congress prior to the passage of ERISA, with subsequent CPI adjustments. While we do not see the necessity for any dollar limits in such arrangements, the current limits have not been shown to be unreasonable, and there appears to be no justification for reducing them.

The most significant change, however, of all the proposed section 415 changes is the elimination of a COLA adjustment on such maximum benefit amounts. If the current limit of $136,000 for defined benefit plan were, for example, providing 50 percent of final average pay for an executive currently, the immediate effect—of the $90,000 maximum—would be to reduce his replacement ratio at age 65 from 50 percent to approximately 33 percent of his final pay—except for any effect of the grandfathering provision. If inflation averaged only 6 percent for the next 10 years, then the executive now age 55 planning to retire at age 65 would find his gross replacement ratio reduced from 33 percent to approximately 18 percent of his final average pay; in 20 years, the maximum replacement ratio would be approximately 10 percent. It is easy to see why most management people would have little interest in the adoption of a new retirement program, or expansion of an existing one, if the result would be a continually diminishing replacement ratio for the management and middle management people.

Similarly, the effect of requiring actuarial reductions in the maximum benefit limits from age 65, instead of the current age 55, would further reduce the maximum amount payable from the plan, and provide additional disincentives for establishment of new plans or growth of existing plans. Based on current assumptions of the Pension Benefit Guaranty Corporation, the $90,000 maximum pension at age 65 might be reduced to approximately $47,000 at age 60 and to about $26,000 at age 55.

When ERISA was being considered, the $75,000 limit was also to be adjusted for an actuarial reduction below age 65; however, when the relationship of such reductions to the benefits provided by the civil service system was brought to the attention of congressional staff, the age was set at age 55 rather than at age 65. The impact of this will be illustrated with enclosed tables to be described in the following paragraphs.

As indicated earlier, it is useful to compare the impact of this bill with the benefits payable under the civil service retirement system, which covers not only the regular civil service employees but congressional staff and Congressmen as well. Such analysis demonstrates very vividly the high degree of discrimination that would result against private sector employees in favor of Government employees if H.R. 6410 were enacted.

Tables 1 and 2 following illustrate the differences that would emerge now and in the future between maximum benefits payable under private plans and benefits from the civil service system for top-level career Government employees—GS-18 for illustrative purposes. Table 1 illustrates the pension payable for retirement on 1/1/84, for an employee hired at age 25, working alternatively under regular civil service or as a congressional staff employee, for contrast with the private plan limits. The benefits are shown for three different retirement ages, 65, 60, and 55, with service periods of 40, 35, and 30 years respectively.

[A table follows:]

Table 1

Comparison of Maximum Benefits Payable Under Civil Service Retirement System to Career Employees Vs. Private Plans If H.R. 6410 Enacted

Retirement on January 1, 1984
Age at Hire = 25

	Civil Service Plan		Private Plan 1/
	Regular Civil Service	Congressional Staff	
A. Retirement Age 65 (40 Years Service)			
1. Final Average Pay (GS 18)	$55,037	$55,037	-
2. Benefit Percentage	76.25%	80.00%	-
3. Initial Pension Amount (A1 x A2)	$41,966	$44,030	$90,000
4. Equivalent CPI-Adjusted Pension 2/	62,616	66,696	$90,000
B. Retirement Age 60 (35 Years Service)			
1. Benefit Percentage	66.25%	80.00%	-
2. Early Retirement Reduction Factor 3/	1.00	1.00	0.52
3. Initial Pension Amount (A1 x B1 x B2)	$36,462	$44,030	$46,800
4. Equivalent CPI-Adjusted Pension 2/	57,293	69,184	$46,800
C. Retirement Age 55 (30 Years Service)			
1. Benefit Percentage	56.25%	75.00%	-
2. Early Retirement Reduction Factor 3/	1.00	1.00	0.29
3. Initial Pension Amount (A1 x C1 x C2)	$30,958	$41,278	$26,100
4. Equivalent CPI-Adjusted Pension 2/	$51,119	$68,160	$26,100

1/ Assuming employee is eligible for maximum pension under H.R. 6410 regardless of earnings level or benefit formula.

2/ This amount represents the equivalent level annual pension which reflects the value of assumed 6%/year CPI adjustments in the Civil Service pension.

3/ Based on current actuarial assumptions used by the Pension Benefit Guaranty Corporation.

Mr. **Boynton**. In these two tables, in addition to showing the initial pension amount payable to the civil service employee, we have also shown the equivalent pension payable by taking into account an assumed rate of 6-percent CPI increases, since CPI increases are automatic under the civil service system. It does seem somewhat inconsistent for Congressmen to be proposing nonindexed maximum pensions for the private sector while being protected themselves by a fully indexed retirement system.

The first example in section A of table 1 shows that for a regular civil service employee retiring at age 65 with 40 years of service, his initial pension amount would be just under $42,000. However, such amount would be increased annually with cost-of-living changes. For example, 10 years later, with 6-percent-per-year increases in the CPI, he would be receiving over $75,000 a year; if he survived to age 85 he would be receiving almost $135,000 per year, as contrasted with a $90,000 maximum for the private sector employee. On the average, however, taking into account the life expectancies of the employees affected, the 6-percent CPI increases would produce an equivalent pension of approximately $62,600 for life, some 50 percent larger than the starting pension of $41,966.

The impact of the actuarial reduction can be seen at retirement ages 60 and 55. For example, under the bill, using the PBGC current actuarial assumptions, the $90,000 limit would be reduced to a maximum of $26,100 if the private sector employee retired at age 55. However, the congressional staff employee with a similar period of service, retiring at age 55, would be entitled to an initial pension amount of $41,278, almost 60 percent higher. Additionally, the lifetime equivalent pension to reflect the assumed 6-percent CPI increases would be over $68,000, 2½ times the maximum permitted to the private sector employee. Thus, even before taking into account the lack of adjustment of COLA increases, it will be observed that the Government employee retiring at age 55 at one of the top grades would be entitled to significantly higher benefits than this bill would permit to a private sector employee.

Table 2 illustrates an even more serious problem, which is the lack of indexing in the $90,000 maximum. Again assuming 6-percent increases both in CPI and pay rates for Government employees, the table indicates, for example, that even for retirement at age 65, the Government employee would receive substantially higher benefits initially than would be permitted under the private plan. If one takes into account the effect of the COLA adjustments on the civil service pension, the situation is even more exaggerated.

[A table follows:]

Table 2

Comparison of Maximum Benefits Payable Under Civil Service Retirement System to Career Employees Vs. Private Plans If H.R. 6410 Enacted

Effect of Elimination of COLA Adjustment

Age at Hire = 25

	Civil Service Plan		Private Plan
	Regular Civil Service	Congressional Staff	Maximum Benefit
A. Retirement Age 65			
1. Retirement in 1984			
a. Initial Pension	$ 41,966	$ 44,030	$90,000
b. Equivalent CPI Adjusted 2/	62,616	65,696	90,000
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 75,155	$ 78,851	$90,000
b. Equivalent CPI Adjusted 2/	112,136	117,651	90,000
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	134,591	141,210	90,000
b. Equivalent CPI Adjusted 2/	200,818	210,694	90,000
B. Retirement Age 60			
1. Retirement in 1984			
a. Initial Pension	$ 36,462	$ 44,030	$46,800
b. Equivalent CPI Adjusted 2/	57,293	69,184	46,800
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 65,298	$ 78,851	$46,800
b. Equivalent CPI Adjusted 2/	102,603	123,898	46,800
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	$116,939	$141,210	$46,800
b. Equivalent CPI Adjusted 2/	183,746	221,882	46,800
C. Retirement Age 55			
1. Retirement in 1984			
a. Initial Pension	$ 30,958	$ 41,278	$26,100
b. Equivalent CPI Adjusted 2/	51,119	68,160	26,100
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 55,441	$ 73,923	$26,100
b. Equivalent CPI Adjusted 2/	91,546	122,064	26,100
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	$ 99,287	$132,384	$26,100
b. Equivalent CPI Adjusted 2/	163,946	218,597	26,100

1/ Assuming Civil Service pay rates increase at 6%/year.

2/ This amount represents the equivalent level annual pension which reflects the value of assumed 6%/year CPI adjustments in the Civil Service pension.

Mr. Boynton. In the "worst case" presented in the table, retirement at age 55 in the year 2004, 20 years from now, we find that the congressional staff employee would be able to retire with an initial pension five times the maximum that would be permitted to be paid from a qualified plan to, say, the president of General Motors. If one takes into account the value of the CPI adjustment in the pension, the ratio goes from five times to more than eight times. Clearly this situation is unreasonable, and produces gross inequities toward private sector employees.

The purpose of tables 1 and 2 is not to demonstrate or criticize the admittedly lush pension program available to Government employees, but rather to point out the inequities inherent in the proposed legislation. If Congress in its wisdom still feels strongly that this is desirable legislation, then obviously it would only be fair to impose exactly the same dollar limits on any Government pension payable to Members of Congress, their staffs, and civil service employees. As can be seen from the tables, if such limits were applied to the civil service system, it would call for reduced benefits immediately after enactment to any Government employee retiring at age 55. In the long term it would substantially reduce benefits payable to Government employees further, in line with the maximum permitted to private sector employees.

Regardless of the tax revenue implications of H.R. 6410, it should also be noted that while some might believe the "tax subsidy" to private pensions gives the mandate for Government control of such pensions, the payments to civil service workers are the direct outflow of tax dollars, and have a more direct and measurable impact on budget figures than the so-called tax subsidy granted private pensions. In fact, if such changes were adopted for the civil service plan, there would be annual savings of several billion dollars in Federal expenditures.

With respect to the reduction of the 1.4 limit on combined plans to 1.0, if one accepted the necessity for imposing dollar or percentage limits on benefits from qualified plans, then I suppose it can be argued that the total limits should be 1.0 rather than 1.4. We disagree with this conceptually, because we believe the 1.4 rule is already too restrictive, and any reduction therein will simply add to the many negative factors inherent in this legislation which will discourage the expansion of coverage of private pension plans. It can be demonstrated that over the long term, the combination of the 1.4 rule and lack of COLA adjustments will affect just about all employees of a corporation, not just the executive groups.

It should be noted that the situations in which the 1.4 limit comes into play involve an organization having two or more plans—at least one defined benefit plan and one defined contribution plan. In this case the Internal Revenue Code establishes a limit of 25 percent of compensation as the maximum contribution that can be made to such combined plans in any one year. One can argue, therefore, that since each plan must meet IRS nondiscrimination standards, the 25-percent limit alone is an adequate control measure.

Using the civil service system again as a benchmark, Congress apparently believes that the benefit levels of such system are reasonable for Government employees. Therefore, a similar level of benefits should be available to private sector employees, if in fact employers could afford it. By contrast with the 25-percent-of-pay limitation on contributions placed on employers affected by the 1.4 limit, the reasonable cost of the civil service retirement plan, if funded on a basis comparable to the ERISA standards required for private plans, would probably run approximately 90 percent of covered payroll. It is hard to see how Congress could feel it is so important to cut back below the 1.4 rule, which has a maximum payroll cost of 25 percent of pay, and requires nondiscriminatory benefits, whereas Congress itself and Federal Government employees are covered by a package of benefits whose value is well over three times that of the maximum permitted private plans. Again we view this as being highly discriminatory in favor of public sector employees.

To repeat, the purpose of contrasting the proposed legislation with the benefits from the civil service retirement system is not to make Government employees the "whipping boy," nor to suggest an overhaul of that program. With or without such comparison, the association believes fundamentally that the concepts underlying H.R. 6410 are wrong and inconsistent with the American free enterprise system. The proposed limitations are restrictions and inhibitions that will retard or strangle the growth of private pensions in the United States. The contrast with civil service benefits and costs is simply intended to point out the extent to which the proposed legislation would be totally inequitable as between public sector and private sector employees.

In general the most objectionable feature of the proposed changes in the section 415 limits is the elimination of the COLA adjustments to the dollar limits, which produce absurd results in future years. The argument can be made that Congress would, from time to time, revise such limits to reflect inflation. The history of tax legislation or regulation suggests this is highly unlikely, particularly since the limits initially apply only to highly compensated employees. For example, the dollar limits written into mimeograph 5717 in the 1940s regarding plan terminations remain unchanged—and totally unrealistic—after 40 years. The maximum amount of $50,000 on the amount of group life insurance which can be provided on a tax-free basis remains the same after almost 20 years, et cetera, et cetera, et cetera. Thus the likelihood is that any dollar limits imposed today would remain unchanged until such limits affected virtually all rank-and-file employees.

The problem of the appropriate level of integration of private pension plan benefits with social security is a highly complex matter that has been studied and restudied for the past 30 years, without any consensus as to a better solution than the current integration rules. It is an extremely complex area; there is no correct mathematical solution to the problem, since one can reach startlingly different conclusions depending upon the assumptions one makes in addressing the problem. Several major efforts have been made in the past 15 years or more to revise these rules, either in regulatory or legislative approaches, including an abortive last-minute effort by congressional staff to include in ERISA a provision which would freeze integration levels. The proposed changes in H.R. 6410 represent another attempt to reduce the degree of integration and add even more complexity to an already complex subject. The proposal as presented for offset plans would be incredibly abstruse, and more important, is not more logical than existing rules. It should be noted that the basic purpose of integration is to provide a reasonable level of benefits in relationship to pay for all salary levels. However, it specifically is not an attempt to provide the identical replacement ratio as a percentage of pay for all salary levels. If it is reasonable to have different levels of pay for different levels of responsibility, then it seems logical that the pension amount should bear some reasonable relationship to pay. The current integration rules work effectively in most plans by providing a replacement ratio related to preretirement income which is very high, often exceeding 100 percent for lower paid employees, tapering on down to a significantly lower percentage for higher income employees.

As an illustration, we have taken the benefit formula from one of our clients which provides a benefit of 1.6 percent of final average compensation for each year of service up to 40 years, reduced by 1.25 percent of social security for each year of service up to a maximum of 40 years—that is, maximum offset equals 50 percent of social security PIA. This is a fairly typical way of allowing for a social security offset, in that the offset amount is related only to service with the employer and is spread over the working career of the employee. Contrary to the assertions of integration critics, most employees are covered by plans which prorate the social security offset based on their period of service with the employer, and an offset of 83 percent of social security regardless of service does not apply to most coverage under offset plans.

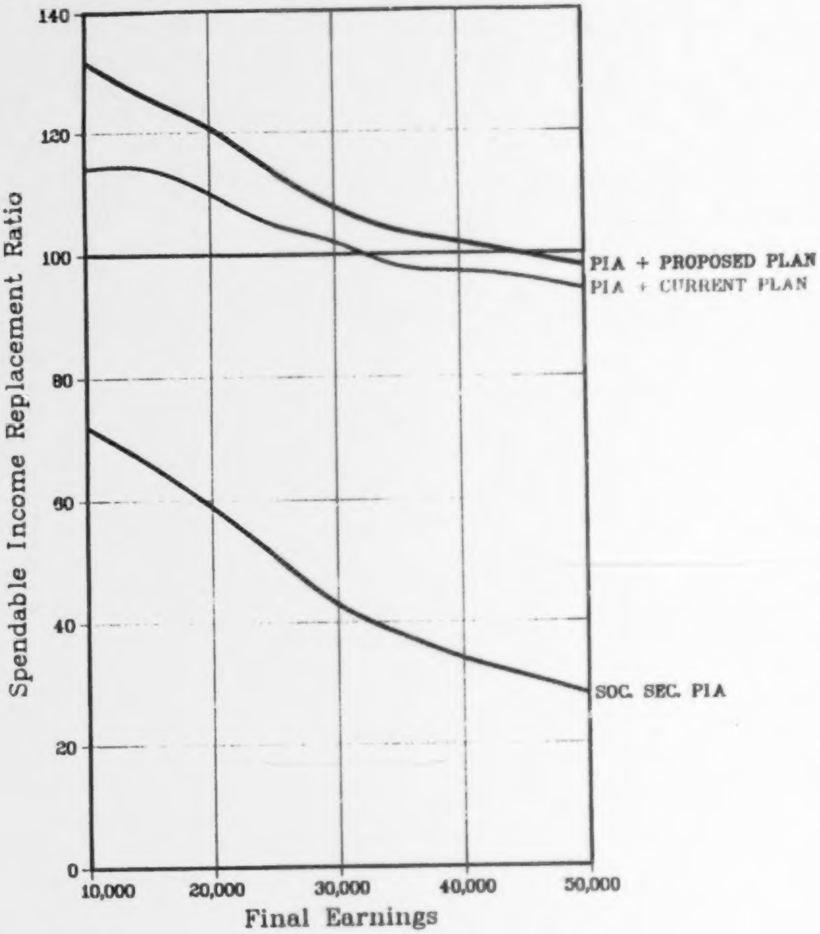
Because of the extremely short time frame between the date the legislation was introduced and the hearing, there frankly has not been enough time to analyze fully the potential impact of the proposed change in the offset rules. It is difficult to guess what changes might finally emerge by regulations, since there are many complex actuarial problems to be resolved in deciding how the determination will be made. However, using the plan described above as a sample, we have attempted to project what the change might be for an employee retiring at age 65 under such plan if required to change to the new offset limit.

To illustrate this impact, we have prepared table 3 following in graphic form which shows the replacement ratio—retirement income divided by final pay—from social security plus the pension in relation to final pay. However, in order to have a realistic comparison, we have determined replacement ratios—retirement income divided by preretirement salary levels—on an after-tax basis, so as to produce a relationship based on spendable income. In table 3, we have developed a graph for an employee with 40 years of service to show this relationship between social security and total retirement income. The percentage ratios were determined by dividing the retirement income, after applicable income taxes, by the annual income just before retirement, also after income taxes and work-related expenses. The effect of using the after-tax income shows the significance of the nontaxability of social security benefits.

[A chart follows:]

Table 3

SPENDABLE INCOME REPLACEMENT RATIO
CURRENT AND PROPOSED OFFSET (H.R. 6410)
RETIREMENT AT AGE 65 IN 1982
SINGLE EMPLOYEE WITH 40 YEARS OF SERVICE



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Mr. BOYNTON. The lower line on the chart shows the value of the primary social security benefit—without dependent benefits—which replaces approximately 72 percent of after-tax income at $10,000 of earnings, diminishing with increasing income to 28 percent at $50,000. The next higher line on the chart shows the replacement ratio for total retirement income under the present plan, involving an offset of 50 percent of social security—40 years times 1.25 percent. It shows that the spendable income replacement ratio is approximately 114 percent at the lower income levels grading down to 94 percent for higher paid employees.

Finally, for illustrative purposes, the top line on the chart shows the approximate impact of the proposed change in the integration rules if such rules were to be fully and immediately applicable. To determine this, we accumulated the social security contributions applicable to various income levels over the last 40 years and then converted such accumulations into an equivalent offset amount, as indicated by the proposed legislation. This significantly reduces the offset from that applicable under the current plan, even though the current plan offsets a maximum of 50 percent of social security, considerably less than the 83 percent maximum offset permitted. The replacement ratio commences at 132 percent of final pay for lower paid employees declining to 98 percent for higher paid. Note particularly the steeper curve. The impact on lower paid employees is to increase their replacement ratio even further than that of the higher paid employees.

While most private pension plans are designed to produce a steadily declining replacement ratio with increasing income, there is a question as to whether it is necessary to change the integration limits so as to steepen the slope of this curve of replacement ratios. If a typical plan today is already producing at least 100 percent of spendable income for long-service employees up to the medium salary range, and still favors lower paid employees even more, is it necessary to push this ratio even higher for lower paid employees by this proposed change in the integration limits?

The illustration is incomplete and other service periods and types of plans could be analyzed, but the limited time to consider such proposal did not permit any further analysis. It is obvious, however, that such a proposal requires much more detailed analysis before implementation.

As for the safe harbor provision, the rule appears to be totally arbitrary with no particular rationale, and would be of no help for offset plans without a total revision of the structure of such plans.

Again, the lack of indexing for CPI changes over the coming years would have a devastating effect in the future and ultimately there would be reverse integration. That is, the benefit unit on earnings above the social security wage base would have to be lower than the benefit on earnings up to the wage base. The current wage base is $32,400, and even with 6-percent inflation, it would only take about 10 years for the wage base to reach $60,000 level. From that point on, there would be reverse discrimination, in that the benefit units above the wage base would always be lower than below. Whether this is a socially desirable objective is perhaps a matter of one's political and personal views, but in any event it is clear that it would be a strong disincentive for the future establishment or growth of pension plans.

We would like to reemphasize the complexity of this problem and that there are no quick fixes, as is evident from past discussions of the topic.

H.R. 6410 would severely restrict the ability of employees to borrow against accounts established in certain types of defined contribution plans. The ability to borrow from one's accumulated account balance is certainly a very valuable right used by a great number of rank-and-file employees, and it would be unfortunate to restrict or curtail it. Considering the 15-percent highest paid employees as key employees for this purpose seems to be far too restrictive, since in very few corporations would there be as many as 15 percent of the employees involved in the decisionmaking level of management.

Again, these provisions of the bill which establish additional restrictions on qualified plans would make them less attractive. Limiting the right of key employees—as defined—to borrow money from their own accounts could lead to the elimination of that right for all employees.

To the extent there may be abuses in individual cases of this right to borrow against the funds, these should be handled on the individual case basis, or by special rules applicable to special situations, rather than a broad-based rule which would affect all plans in the country. This is another example of provisions in H.R. 6410 which, when combined with the others, simply makes qualified plans far less attractive.

H.R. 6410 would drastically alter the ability of certain types of corporations to provide retirement benefits to their employees, by sweeping in under H.R. 10 rules a number of different types of corporations which have historically operated as corporations in every respect. Certain professions have historically been required by statute to operate as partnerships or self-employed—principally the fields of medicine, law, and accounting—and only recently have some been able to incorporate for tax and other reasons. The other types of organizations that are rather arbitrarily swept into this provisions by H.R. 6410, specifically engineering, architecture, actuarial science, performing arts, athletics, and consulting, have never been required by law, for reasons of personal liability or other, to practice in a partnership or a self-employed form. Accordingly, it seems arbitrary and punitive to sweep in these groups which have traditionally operated as corporations in every respect. To discriminate against individuals by reason of their profession or form of organization is totally unfair and artificial. Many of these organizations, including my own, are sizable organizations spread all over the country or indeed all over the world, and we can see no justifiable reasons for requiring employees of these organizations to be treated as self-employed individuals. My own company has over 1,200 employees spread all over the world with several hundred stockholders, including many at the nonprofessional level.

The effect of such changes would be to create chaos in terms of existing benefit programs of these organizations, with substantial loss of promised benefits in many instances, not only to professionals at all levels but to rank-and-file employees as well. Additionally, it would seem that the provision would create a whole host of administrative problems in trying to determine whether or not one belonged in the select group. For example, some practitioners in the actuarial consulting field are associated with major international insurance brokerage firms. Does that make: One, all employees of the insurance brokerage firms subject to H.R. 10 rules, two, only those associated with the employee benefit consulting portion of the business, or, three, if the employee benefit arm is only a small portion of the total, would the whole organization be exempt? Obviously there are serious administrative problems not contemplated by the proposed legislation.

If the bill is truly intended to encourage the growth of pensions and other forms of retirement income, this approach is exactly backwards. What should be done is to extend the corporate rules for self-employed individuals or partnerships, rather than to bring legitimate corporate plans under the self-employed rules.

The bill proposes to bring all types of fringe benefit plans under a single umbrella of antidiscrimination rules. It would provide that any key employee who is a participant in what was deemed to be a discriminatory fringe benefit plan would have the employer cost of such plan which is attributable to him included in his gross income. The wording of the proposed law is extremely vague, and would give broad discretion to the Secretary to write regulations defining what are deemed to be discriminatory benefits or coverage. We fail to see the need for such a provision in the absence of documentation to the effect that significant discrimination does exist. We are particularly concerned that the vagueness of the wording gives such broad authority to the Secretary to define discriminatory benefits or coverage.

The language of the bill, dependent upon how interpreted by the Secretary, could result in significant cutbacks or limitations on benefit programs which have not been generally regarded as discriminatory in the past. If this were the case, we would expect further cutbacks in some of these fringe benefit programs, and the substitution of alternative forms of compensation to the highly compensated employees.

In general, group life, and medical insurance plans have been extended to a broad segment of the working population, perhaps due to the lack of a lot of fussy rules and regulations. To impose another administrative bureaucracy to oversee these areas would simply dampen the growth of these benefits in the long run. It could be particularly damaging to the rank-and-file employees.

The proposed dollar limitation on the estate tax exclusion of certain distributions from a qualified plan would be one more negative factor or disincentive in H.R. 6410 to the establishment or expansion of private sector retirement plans. For many years, the total value of death benefits payable from qualified plans was excluded from the estate tax. Recently, the Internal Revenue Code was amended to limit this advantage to distributions spread out over a period of years, and coincidentally eliminated special lump sum income tax rules for such distributions. The H.R. 6410 proposal is still a further limitation on this feature. It also suffers from the same defect as the revised section 415 limits in H.R. 6410—the lack of any COLA or CPI indexing, so that in future years the limitation will affect an increasing number of employees.

As is obvious from the comments, we do not believe that H.R. 6410 represents very good or desirable legislation. The haste with which the bill is being considered is of particular concern, considering the significant impact it would have on many thousands of qualified plans in this country. In several areas it appears that the provisions may be aimed at a few special cases where individuals or organizations are abusing the flexibility permitted them. If this be the case, it would seem much more desirable to focus on the limited areas that give rise to the concern, rather than devise some arbitrary rules which would have major impact on the vast majority of the plans in this country which are well run and do not discriminate in favor of highly paid employees by any reasonable interpretation of that term. A few well-placed rifle shots in this case would be effective in solving the problem, instead of using a cannon to undermine the whole foundation of qualified plans.

Thank you.

[The prepared statement follows:]

SUMMARY OF STATEMENT BY EDWIN F. BOYNTON, VICE PRESIDENT AND ACTUARY OF THE WYATT CO., WASHINGTON, D.C., ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION

This statement is presented in behalf of the National Small Business Association, a multi-trade association representing approximately 50,000 small business firms nation wide. Although I am speaking on behalf of the Association today, I am otherwise employed as a consulting actuary with The Wyatt Company, a national firm of actuaries and employee benefits consultants. I have had over 25 years experience as a consulting actuary with the Wyatt Company.

We have prepared a rather extensive written statement, submitted to the Committee last Monday, which touches upon most of the major aspects of the bill. As a general overview, our opinion is similar to that expressed by many preceding panel members: that the effects of such legislation would be quite different than anticipated by those drafting it. We would expect the bill to be a very strong disincentive to the establishment of new plans or to the expansion of existing plans. It could be a strong incentive for many employers to terminate their plans, in the same fashion that ERISA was a major causal factor in the termination of over 30,000 defined benefit pension plans in the 7 years following its passage. In the long run, the impact of the bill will be damaging to the rank-and-file employees, and probably have little real effect on the top management employees at which it is apparently aimed.

Rather than repeat the comments made by others with different words, I would like to take my few minutes to focus on one particular aspect of this proposed legislation which I find very disturbing and unfair, not only as a consulting actuary in the employee benefit field, but even more so as a tax payer. The bill would initially cut back benefits payable to highly paid employees, but in the long run, as the result of eliminating cost-of-living adjustments in such limits, it would cut deeper and deeper into all ranks of employees and severely restrict pensions payable from private plans. If the employee goes out on early retirement, so much the worse.

By contrast, the people who drafted this bill, who are sitting in front of me, including Congressmen, Congressional staff, as well as the entire Civil Service Force are covered by one of the most generous and most expensive pension plans covering any staff group in the country. The plan has extremely generous benefit levels, unreduced early retirement at age 55 and full CPI indexing. If the federal government had to meet the true actuarial costs of the plan, similar to standards required of private employers, the costs would exceed 90 percent of covered payroll. As it is, with the special funding approach employed, it is currently a 33 percent of payroll cost and increasing rapidly. No private employer could afford such a plan and yet H.R. 6410 implies that the comparatively modest programs of private plans are extravagant "giveaways" of tax dollars. By contrast with the 90 percent actuarial cost of the Civil Service Plan, employers whose plans are affected by the 1.4 limit, which this bill would reduce to 1.0, are presently limited to a maximum tax deductible contribution of 25 percent—and each plan must meet IRS non-discrimination tests.

Our testimony notes that even for retirement in 1984, the Congressional staff employee with 30 years of service could retire at age 55 with an initial pension amount of approximately $41,000 (page 9), or about 60 percent higher than the estimated $26,000 maximum which H.R. 6410 would permit under a private plan. Further, such amount would increase with cost of living so that 10 years later, with only 6 percent increases in the CPI, he would be receiving over $73,000 a year and 20 years later, $131,000 a year. This contrasts with the maximum annual lifetime pension of approximately $26,000 payable to the private sector employee, with no indexing permitted because he is already at the maximum pension amount.

If one projects out only 10 years into the future (page 11), we find for example, that the Congressional staff employee retiring at age 55 would receive an initial amount of pension equal to 3 times the maximum amount which would be allowed to a private sector employee, again with full cost-of-living adjustments. In 20 years, it would be 5 times the private plan maximum. We think this is grossly unfair. If private pension plans are to be subjected to specific dollar limits without indexing, then shouldn't Federal Civil Service pensions likewise be restricted?

Representative Rostenkowski has made several references to the budget considerations. Let's talk about the combination of the Civil Service Retirement System and the Military Retirement System, which have probably a trillion dollars of unfunded actuarial liabilities. The elimination of cost-of-living adjustments in these plans would save several hundred billion dollars in future government costs, with several billion dollars to be saved in the next few years by such a step. I do not have precise numbers on this but they could be determined; I am sure at least, that the number of "zeros" is correct.

Very frankly, it would be a serious mistake to take such a step, and we do not advocate it. It would totally undermine the morale of all government employees and make government jobs less attractive. I am using this simply as an example to point out that elimination of COLA adjustments as proposed by H.R. 6410 is completely inappropriate and discriminatory. However, if Congress insists that this approach be taken with private plans, it seems only fair and just that all government employees be affected by the same kind of limits as are applied to the taxpayers who pay for their salaries and benefits.

Chairman ROSTENKOWSKI. Thank you, gentlemen.

Mr. Rangel will inquire.

Mr. RANGEL. Mr. Boynton, you know that our salaries are capped, and while they are indexed, that under the bill that I authored that you can index benefits subject to the cap, the same way we do with the pension.

Mr. BOYNTON. The civil service pensions are not capped.

Mr. RANGEL. We are capped here in the Congress. Civil service pensions are capped, the question of indexing is a moot question, because you can index all you want, but it is subject to the cap that we have in the bill.

Another problem we have is that the major thrust of this legislation deals with tax-deferred contribution to a pension fund. You know that Members of Congress pay taxes on 8 percent of their incomes into a pension fund. We pay taxes on our plan. Here we are talking about plans where the employee under the plan is trying to avoid the payment of taxes.

Lastly, as relates to the comparisons for early retirement, I do not know whether I understood your testimony. I know that you are aware that under the congressional plans there is a severe penalty of 2 percent for early retirement, and you pay dearly for it. I understand that Mr. Shannon questioned some of the figures that he had read earlier. Further, that Treasury believes and so testified, that this reduction under the hypothetical you suggested does not bring the benefits to $26,100 as you indicated, but under their formula $45,000 would be the benefit for early retirement. I see, however, that you are attempting to show examples of where you believe people can get hurt by the arbitrary decisions of a high-paid executive to abolish a plan. That is always a threat. We do not know what the future holds.

Certainly, Mr. Boynton, you will be hearing more from this committee relating to your hypotheticals, and I hope that we can keep the exchange going. If you are using one set of facts for the private venture and forget the restrictions that we have under congressional plans.

Mr. BOYNTON. May I comment? The actuarial facts we use come from the Pension Benefit Guaranty Corp. They are current rates which we did not invent.

Mr. RANGEL. You know we pay taxes on our 8 percent.

Mr. BOYNTON. We pay taxes on social security. If you add social security's benefits into the figures, you will still come up with the discrimination.

[The following was subsequently received:]

SUPPLEMENT TO STATEMENT OF EDWIN F. BOYNTON, ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION

This statement is intended as a supplement to the original statement of the Association dated June 8, 1982, following the hearings of the Ways and Means Committee on June 10, 1982. The purpose is to provide additional information to respond to comments and questions raised principally by Rep. Rangel.

A comment was made that there was a "cap" on Congressional pay so that the pension amounts indicated in Tables 1 and 2 would be limited by such cap. However, as far as we can determine from a review of applicable statutes and discussions with representatives of the Office of Personnel Management (OPM), there are no such limitations imposed on cost-of-living adjustments to Civil Service pensions. When the $36,000 "freeze" on maximum Civil Service pay levels was imposed a few years ago, some of the pensioners who retired near the beginning of the freeze continued to receive COL increases and were, in fact, receiving pensions in excess of $36,000 while their successors still in active employment were being held to the $36,000 level.

Accordingly, we believe that the pension amounts indicated in Tables 1 and 2 of our statement are valid, since current statutes do not appear to impose any limits on the application of cost-of-living adjustments in Civil Service pensions.

In a discussion with a member of the Congressional staff immediately following the testimony, it was also contended that the "Section 415" limits would apply to Civil Service pensions as well as qualified private plans. We have been unable to find any statutory or regulatory support for this interpretation, the Civil Service Pension Act does not contain the 415 limits, nor is the OPM staff aware of any such restriction. We would be interested in the interpretation as to how the Section 415 limits do become applicable to Civil Service pensions.

A further point was made regarding actuarial reductions applicable to the $90,000 limit. Reference was made to the possibility that the actuarially reduced amount at age 55 might be as high as $45,000, as compared with the $26,100 figure cited as an illustration in our statement. Since we cannot predict what actuarial basis might be prescribed in IRS regulations, we applied assumptions promulgated by the Pension Benefit Guaranty Corporation for current plan terminations as being representative of the current situation. Assumptions which would produce a reduced maximum pension of $45,000 at age 55 (i.e., 50 percent reduction) are based on mortality and interest assumptions that were applicable 25–30 years ago.

The comment was also made that the comparisons between Civil Service and private pensions made in Tables 1 and 2 did not reflect the fact that government employees are required to make contributions (7 percent—Civil Service, 7½ percent—Congressional staff, and 8 percent—Congressmen) to the Civil Service System which fund a part of their pension, and such employee-purchased annuities would not be included within the section 415 limits.

Accordingly, we have adjusted the Civil Service pension amounts to drop out the amounts which might be attributable to employee contributions. The adjustment is based upon the assumptions used to determine employee-purchased benefit under

ERISA. Tables 1A and 2A attached present the revised figures. Although the 7 percent to 8 percent contribution rate seem onerous to affected employees, it funds only a modest portion of the total value of the generous benefits provided by the System. Considering the fact that the total actuarial costs for the System if funded by conventional actuarial methods would be 90 percent—100 percent of covered payroll, it is not surprising that 7 percent/8 percent employee contributions fund only a small portion of the benefit.

In comparing Tables 1 and 1A, it will be observed that the pension for the regular Civil Service employee retiring at age 55 which is attributable to government contributions is $25,243, approximately 18 percent less than the gross pension of $30,958 indicated in Table 1, and slightly less than the $26,100 maximum permitted by H.R. 6410. However, the entire value of cost-of-living increases is paid for the government and the equivalent CPI-adjusted pension of $41,682 exceeds the $26,100 maximum permitted by H.R. 6410 substantially.

From Table 2A, the adjusted annual Civil Service pension at retirement age 55 in 1994 would be $45,965, approximately 1.75 times the maximum private pension. For similar retirement in twenty years, the employer-provided Civil Service pension would be $83,049, or about 3 times the maximum private pension.

Thus, even after adjusting for employee contributions to the Civil Service Retirement System, the pensions payable to Civil Service and Congressional Staff employees in the future would substantially exceed the maximum amounts permitted under private pension plans if H.R. 6410 were to be enacted.

Table 1A

Comparison of Maximum Benefits Payable Under Civil Service Retirement System to Career Employees Vs. Private Plans If H.R. 6410 Enacted (Including reduction in Civil Service Plan benefit for the benefit attributable to employee contributions)

Retirement on January 1, 1984
Age at Hire = 25

	Civil Service Plan		Private Plan 1/
	Regular Civil Service	Congressional Staff	
A. Retirement Age 65 (40 Years Service)			
1. Final Average Pay (GS 18)	$ 55,037	$ 55,037	-
2. Benefit Percentage	76.25%	80.00%	-
3. Initial Pension Amount (A1 x A2)	$ 41,966	$ 44,030	$ 90,000
4. Less Benefit due to Employee Contributions 2/	32,441	33,825	90,000
5. Equivalent CPI-Adjusted Pension 3/	48,404	50,469	90,000
B. Retirement Age 60 (35 Years Service)			
1. Benefit Percentage	66.25%	80.00%	-
2. Early Retirement Reduction Factor 4/	1.00	1.00	0.52
3. Initial Pension Amount (A1 x B1 x B2)	$ 36,462	$ 44,030	$ 46,800
4. Less Benefit due to Employee Contributions 2/	28,961	35,993	46,800
5. Equivalent CPI-Adjusted Pension 3/	45,507	56,556	46,800
C. Retirement Age 55 (30 Years Service)			
1. Benefit Percentage	56.25%	75.00%	-
2. Early Retirement Reduction Factor 4/	1.00	1.00	0.29
3. Initial Pension Amount (A1 x C1 x C2)	$ 30,958	$ 41,278	$ 26,100
4. Less Benefit Due to Employee Contributions 2/	25,243	35,155	26,100
5. Equivalent CPI-Adjusted Pension 3/	41,682	58,049	26,100

1/ Assuming employee is eligible for maximum pension under H.R. 6410 regardless of earnings level or benefit formula.

2/ The estimated benefit attributable to employee contributions (7% for regular Civil Service and 7½% for Congressional staff) was determined using conversion factors determined by the IRS as appropriate for converting employee contributions to an equivalent benefit.

3/ This amount represents the equivalent level annual pension which reflects the value of assumed 6%/year CPI adjustments in the Civil Service pension.

4/ Based on current actuarial assumptions used by the Pension Benefit Guaranty Corporation.

Table 2A

Comparison of Maximum Benefits Payable Under Civil Service Retirement System to Career Employees Vs. Private Plans If H.R. 6410 Enacted (Civil Service Plan Benefit has been reduced by the benefit attributable to employee contributions)

Effect of Elimination of COLA Adjustment
Age at Hire = 25

	Civil Service Plan		Private Plan
	Regular Civil Service	Congressional Staff	Maximum Benefit
A. Retirement Age 65			
1. Retirement in 1984			
a. Initial Pension	$ 32,441	$ 33,825	$ 90,000
b. Equivalent CPI Adjusted 2/	48,404	50,469	90,000
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 59,431	$ 62,004	$ 90,000
b. Equivalent CPI Adjusted 2/	88,675	92,514	90,000
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	$107,976	$112,694	$ 90,000
b. Equivalent CPI Adjusted 2/	161,107	168,146	90,000
B. Retirement Age 60			
1. Retirement in 1984			
a. Initial Pension	$ 28,961	$ 35,993	$ 46,800
b. Equivalent CPI Adjusted 2/	45,507	56,556	46,800
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 52,892	$ 65,559	$ 46,800
b. Equivalent CPI Adjusted 2/	83,109	103,012	46,800
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	$ 95,828	$118,592	$ 46,800
b. Equivalent CPI Adjusted 2/	150,574	186,343	46,800
C. Retirement Age 55			
1. Retirement in 1984			
a. Initial Pension	$ 25,243	$ 35,155	$ 26,100
b. Equivalent CPI Adjusted 2/	41,682	58,049	26,100
2. Retirement in 1994 (6% Increases) 1/			
a. Initial Pension	$ 45,965	$ 63,770	$ 26,100
b. Equivalent CPI Adjusted 2/	75,899	105,299	26,100
3. Retirement in 2004 (6% Increases) 1/			
a. Initial Pension	$ 83,049	$114,986	$ 26,100
b. Equivalent CPI Adjusted 2/	137,133	189,869	26,100

1/ Assuming Civil Service pay rates increase at 6%/year.

2/ This amount represents the equivalent level annual pension which reflects the value of assumed 6%/year CPI adjustments in the Civil Service pension.

Mr. **Rangel**. Do any of you sitting on this panel believe that an employer should be able to charge to their contribution contributions that have been made for the employee by prior employers?

Mr. **Moran**. I think you are overlooking that with the turnover that all of us suffer we have employes that we have paid into social security for who are no longer with us.

Mr. **Rangel**. I do not think I made the question clear. Where an employee had benefits from four pension plans because he had four previous employers, and you, Mr. Moran, are now his fifth employer, should you enjoy the benefit of the contributions that had been made by prior employers to that employee's plan and offset his benefits that you have nothing to do with?

Mr. **Moran**. If that was the entire picture, I would agree with you. I think what happens is in those other four employer plans he has employees in his system that I have paid into the system. That is the only point I am making.

Mr. **Rangel**. Suppose he did not have any employees——

Mr. **Moran**. Take the whole together, certainly there are individual benefits and inequities.

Mr. **Rangel**. Do you support the loans that we have in pension plans? Do you think it equitable that people can put money in a retirement plan and take it out the next day and still not pay tax? Do you support the interest rate of whatever is charged, providing a deduction, when the interest that they pay goes into their own trust fund? Is that good banking policy?

Mr. **Moran**. I do not think it has anything to do with banking policy. Unfortunately, there are a lot of people who borrow things that do not use banks.

Mr. **Rangel**. Do you support that concept?

Mr. **Moran**. The concept that is in there, the law says that the rate has to be at a reasonable rate.

Mr. **Rangel**. Who cares what the rate is? You deduct the rate, and what you pay goes into your own fund.

Mr. **Moran**. If the money had never been borrowed, that money would have been invested in that fund and earned anyway.

Mr. **Rangel**. We are talking about retirement, pension funds, and you do not have a problem with it? Listen, you are a banker. If you do not, then no one should.

Mr. **Moran**. I do not think that I am making clear the distinction that I want to make here. I am saying that when those moneys are borrowed from the fund they are not in the fund to be invested. Were they in the fund, they could be invested and earning a rate of return. It is my understanding that is why the law says that you must pay a reasonable rate of interest when you borrow from the fund, because it is instead of a fund investment. It is a tradeoff.

Mr. **Rangel**. Everyone would rather do that than go to your institution, so it makes a lot of sense.

My last question deals with integration on social security. The Treasury indicated today that the employer contribution to social security is not the 7 percent that is in existing law, but is actually 5 percent. There is no one here that would object to using 5.4 percent, which is in the law. No one here would object to using actual contribution rather than the one that is just in the law?

Mr. BOYNTON. The entire benefit structure in integration rulings in the past have been related to social security benefits, not to contribution. The 7 percent, the long-range funding cost of the benefit attributed to social security versus the current pay-as-you-go system that is running into deep trouble already, so to change to 5.4 now would be particularly inappropriate with the current consideration of financing. I do not see how 5.4 can stay where it is. To change it to 5.4 right now would be inappropriate.

Mr. RANGEL. The fact is that we are talking about an employer contribution, and you say that the contribution is actually 5.4. You do not argue with the Treasury?

Mr. BOYNTON. I do not argue with the number.

Mr. RANGEL. You do not argue with the number. You say it would be inappropriate to use the actual contribution, which is 5.4? That would be inappropriate?

Mr. BOYNTON. Integrating with the social security benefits, is appropriate. We have a social security structure of a pay-as-you-go payroll tax and not a true cost. That is why we prefer the benefit route.

Mr. RANGEL. Have you seen anything in the bill that would mandate that rank-and-file employees receive reduced benefits?

Mr. CASSIDY. If the social security taxes were increased, these rules could reduce the benefits to the lower-paid employees from private plans more than is permitted currently. Now you can offset the contribution plans by 7 percent of salary below the taxable wage base. Under the current FICA tax rate of 5.4, this proposal is a smaller offset. However, the effects of the proposal are uncertain. This depends not only on social security tax rate but the assumptions that Treasury might come up with to be used in translating those taxes into a benefit. Now we are having difficulty in determining what the actual cost of those benefits might be.

Mr. RANGEL. You know I do not want to adversely affect the benefits received by the rank-and-file. You are saying that I am adversely affecting the benefits received by the rank-and-file if I say that employees should only charge to their pension plan the contribution that they have actually made to the social security benefits of that employee?

Mr. CASSIDY. Just in that context I am talking about the context of the whole bill. The way the present bill is set up——

Mr. RANGEL. Integration, the changes were the employer takes a benefit for 7 percent, but he is contributing 5.4 percent. The employer takes advantage of all the work experience and benefits to the employee. I am saying restrict him to the actual benefits the employer is contributing. You are not saying that those things are not hurting the benefits of the rank-and-file, are you?

Mr. BOYNTON. One of the problems we have had with the bill is there has not been time to adequately make enough projections on what the effect would be. But the fact is that some limited projections we have made indicate that effect, yes. Rank-and-file employees could well be hurt by the proposed discrimination rules, and we will be happy to make more projections and provide the information. We do not know the total answer yet, because we just have not had time to do all the work.

Chairman ROSTENKOWSKI. Mr. Duncan will inquire.

Mr. **Duncan**. Thank you, Mr. Chairman.

I would also like to thank the panel.

The loan provision seems to be the most controversial section of the bill. The present law provides that all employees may participate in the loan provisions. I would be interested in knowing if you have information what element of people—for example, Mr. Moran, at your bank, is it your high-paid employees that participate in the loan provisions, or all your employees? I know they are all eligible, but anyone else?

Mr. **Parfitt**. Maybe I can respond to that. We generally have the lower-paid that are interested in the loan provisions. They do not have collateral for loans from other sources. Our indications are that they are used for good reasons, education, housing, this type of thing, and I am sorry that Congressman Rangel left, but if you are talking about saving money for retirement, an individual needs money for an emergency situation, and you have a sum that is in the fund but he comes to retirement and has a huge debt because he has had to borrow money from other sources, he is no better off. He does not have any more net worth.

Mr. **Duncan**. Are most of the loans repaid?

Mr. **Parfitt**. They have to be repaid by law.

Mr. **Duncan**. If they are not repaid then you forfeit.

Mr. **Parfitt**. We have not had any not repaid.

Mr. **Duncan**. What loan length do you make?

Mr. **Parfitt**. The maximum loan rate is 5 years.

Mr. **Cassidy**. As far as we see it, since the loan provision is available to help all participants, we are beginning to think that all participants are becoming more interested because of the financial situation they are in now. Also, because of the withdrawal restrictions in IRA's, employees are not able to get their money back right away, we are finding that to the employees this is becoming more of an attractive provision.

As far as the security in the investments, I would like to just make a comment that because of the present stringent rules where trustees can be personally held liable, the interest rate provisions and everything else, we do not see the problem with allowing loans for everyone. As long as the rules are obeyed, we think that it is a satisfactory provision.

Mr. **Duncan**. Do you find your lower-paid employees participating at about the same rate as the higher-paid employees?

Mr. **Cassidy**. I would say at this point no, that the lower-paid employees are not necessarily taking advantage of it, but that is because most of the prudent trustees will allow loans equal to the accrued benefit of those employees, and that may not be a large amount in some instances in the earlier stages.

Chairman **Rostenkowski**. Mr. Cassidy, it is my understanding that the cap on loans would not affect rank-and-file employees. It is just the upper 50 percent.

Mr. **Parfitt**. That depends upon your definition——

Chairman **Rostenkowski**. There is no difference from present law in how rank-and-file employees would be able to borrow under the Rangel bill.

Mr. **Cassidy**. Mr. Chairman, I would like to comment that what is happening is the incentive to the employer—you cannot forget that in the private sector—the incentive to the employer is reduced because of the administrative costs involved, and the fact that some of the rank-and-file may be able to take out some loans. My feeling is, and our experience is going to indicate this from what we hear, that employers are not going to bother with loan provisions and pension plans if they are not able to take the benefit, and one of the benefits that we are seeing and one of the benefits that the employer is seeing is the fact that he may be able to take out a loan down the road.

Chairman ROSTENKOWSKI. I do not mean to impose on your time, but you appear to be saying that if the upper 15 percent cannot benefit from the loan provision, then they will deny it to the rank-and-file?

Mr. CASSIDY. They just may not bother allowing that provision in.

Chairman ROSTENKOWSKI. You are saying that because the highly compensated cannot participate in the loan provision, they will cut it out for the lower-paid group?

Mr. CASSIDY. One of the incentives to setting that up is the loan provision. If a higher-paid employer says that that is no longer an incentive, he may not bother allowing that provision into the plan.

Chairman ROSTENKOWSKI. The answer to my question is yes?

Mr. CASSIDY. Yes.

Mr. NOLAN. I am in disagreement with most of the people on the panel, because I do not support loans to participants in profit-sharing or retirement plans except in cases of extreme emergency. I do not think the distinction between key employees and other employees is appropriate. I am opposed to it across the board except in extreme emergency. The issue is the integrity of the funding of employee benefits, and it seems to me inappropriate if the tax inducement is for retirement planning to permit loans to employees of any type.

Chairman ROSTENKOWSKI. Thank you.

Mr. Duncan will inquire.

Mr. DUNCAN. I have no further questions. Thank you, Mr. Chairman.

Mr. DIAMOND. May I comment on Mr. Rangel's questions on integration for a moment? Integration is exceptionally complex. In terms of the benefit that is provided by employers, it should be focused upon as a benefit, because the social security system for instance is not supposed to be a pay-as-you-go system. There are supposed to be earnings on the fund so that the moneys contributed should grow with time to provide benefits that are larger than the actual dollars put in.

Also, if we do not take into account the total of the social security system, just the segment that any given employer pays in, then we are going to have the anomaly of a greater benefit and a greater cost for new employees than for the loyal employees that spend their life with the company.

I do not know the answers, but I do know that it is so very complex that it needs the kind of study that only time can give it. These questions do not lend themselves to quick answers.

Chairman ROSTENKOWSKI. Thank you very much.

The Chair calls Mr. Halperin, Mr. O'Farrell, Mr. Dearnley, Mr. Mentz, and Mr. Kubiczky.

Gentlemen, welcome to the committee. I appreciate your joining us this afternoon to discuss this pension reform act.

Mr. Halperin, I especially want to thank you for participating. It is always a pleasure to have you back here. We have shared quite a few moments together in the past. Would you like to begin with your testimony?

STATEMENT OF DANIEL I. HALPERIN, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER (FORMER DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX LEGISLATION)

Mr. **Halperin**. Thank you, Mr. Chairman. It is a pleasure to be back in front of this committee.

Let me say first that I support H.R. 6410. Obviously adjustments are needed to take care of problems that people have raised, but I think the general thrust of the legislation is sound and ought to be enacted into law.

I think from what we have heard today that no one is talking about the need to facilitate the ability of people to make tax-deductible contributions up to the large amounts permitted today. The focus of everyone has been on the need to provide for retirement security of rank-and-file employees. It is just not necessary to provide excessive tax benefits to high-income people in order to achieve that goal. Some people seem to be saying that unless they can keep the benefits they have today, they will not play the game, they will cancel their pension plans. I do not believe that to be the case.

I think even with H.R. 6410 there are overly generous benefits. No one is going to run away from them just because they once had more. If I am wrong about that as Mr. Chapoton said in his testimony, then we are barking up the wrong tree. If every effort that we make to increase the retirement security for rank-and-file employees runs into the argument that if you try to spread the pension benefits to more people the plan will be discontinued, then we better find a better way to provide that kind of retirement security.

I think it is true that it is possible under this bill that if the top executives get less they will revise their plans so that the rank-and-file employees will get less as well. That is not a reason to oppose the bill. That is a reason to revise the legislation so this kind of modification is not possible.

Some people have pointed out that the $90,000 limit will impact on or reduce the benefits of 99 percent of the employees under age 30. Obviously, however we get there, if it is true that 99 percent of the people are making $90,000 a year, the limit will be raised. Obviously I do not object to that happening.

But with respect to the situation as it exists today, I think it is important to make at least two changes. One, we need to revise the integration rules so it is impossible for plans to cover only those earning in excess of the social security wage base. The premise of the tax support for private pension plans is that social security alone does not provide full replacement for rank-and-file employees. Yet we have profit-sharing plans, for example, that only contribute for people who are earning in excess of $32,400 a year. A plan that does that, that provides nothing at all for people earning less than that amount, has no justification for public aid. I think we need to revise the integration rules so that all plans must provide benefits on the first dollar of salary. If that happens, the concern that some companies will cut out their defined contribution plan and leave only the defined benefit plan which provides no benefits for the rank-and-file because they are all integrated out of it will not occur. We have to prevent that from happening.

It is also important to put a limit on the amount of salary that can be taken into account. If we are permitting contributions of 25 percent and someone desires to contribute the maximum under this bill, $30,000, for himself, he should be required to contribute 25 percent for all others. Just as social security has a limit on the amount of salary it covers, up to $32,400 this year, there is a reason to have a limit on the maximum salary for which you will get tax benefits, a tax subsidy to help replace. If you are earning in excess of $120,000 a year, you should be able to provide for your own retirement savings on earnings over that amount. With an earning limit of $120,000, individuals earning $200,000 a year who now may be contributing at a 25-percent level will not be able to cut the contribution rate to 15 percent and still get the full $30,000 benefit.

In this regard I disagree with the point that was made by Mr. Nolan, whose testimony I generally agree with. We should not raise the ceiling on H.R. 10 plans as we did last year. What we did when we raised the ceiling from $100,000 to $200,000 was to permit professionals and self-employed to contribute more to their own plans without contributing a nickel more for employees. That would be the result if we raise the ceiling from $200,000 to $400,000. In summary, if we want to prevent people from lowering the benefits for the rank-and-file, we can reduce the salary to be taken into account.

With respect to sections 5 and 6 of the bill I agree with the Treasury. Parity is the proper goal, but we cannot always get there by extending the most favorable tax treatment that one person has to everybody else. Therefore, those restrictions in H.R. 10 which are sound should be extended to other situations.

Second, we need to be sure that the two situations are alike. We have to remember that the goal of the private pension system is to provide security for rank-and-file employees. We do not provide the same tax benefits to those who save on their own; we reserve it for those who cover their employees as well. We should not lose sight of this. We should focus on whether employees are obtaining a benefit from the plan.

It would be sensible policy to favor those plans that provide substantial benefits for the rank-and-file employees. This was the approach suggested by Treasury, and I agree with it. If we are not ready to do that, we have to recognize that professional corporations tend to be more topheavy, have fewer rank-and-file per executive, owner, professional than other businesses, and therefore it is appropriate if we are not going to look explicitly at each plan, to generally see whether more restrictions are necessary to insure that these plans cover a wider range of employees.

In summary, I believe H.R. 6410 is on the right track, and I think we ought to go ahead with it.

[The prepared statement follows:]

STATEMENT OF DANIEL I. HALPERIN

Mr. Chairman and Members of the Committee, my name is Daniel Halperin. I am a Professor of Law at Georgetown University Law Center. I have had 20 years experience in the area of private pensions and employee benefits in private practice, programs of continuing legal education, in government and as an academic.

H.R. 6410 is a good bill. We can argue about details and make adjustments where necessary to prevent unintended effects. But the essential approach of H.R. 6410 should become law.

The tax law does not treat all compensation alike. Some forms of compensation, such as amounts used to pay medical insurance premiums or for group term life insurance up to $50,000, are free of tax. Amounts set aside, ostensibly for retirement, in so-called qualified pension or profit-sharing plans are not taxed until actually received. Thus, the tax law distorts individual choice and causes employees to accept compensation in particular forms, presumably favored by public policy. For those who can take advantage of this opportunity, the tax burden can be substantially lower.

Of course, the higher one's tax rate, the greater the saving. Quite simply tax exemption means nothing to those who pay little or no tax anyway. As to savings for retirement, for example, it is quite obvious that the greatest tax subsidy or incentive is provided to those who are most likely to be able to save without such help.

If we are to continue to favor one form of compensation over another, we need to take steps to make sure that the benefits are more equitably divided. Tax subsidized compensation should not be received disproportionately by high income employees. H.R. 6410 moves in that direction. It strengthens and extends the requirement that these plans not discriminate in favor of the higher income. The bill insures more coverage for the rank and file and most importantly H.R. 6410 reduces the total amount of subsidy that any one individual can receive. We certainly need to establish the principle that budget control requires that we look just as carefully at tax expenditures as we do at direct spending.

LIMITS ON CONTRIBUTIONS AND BENEFITS (SEC. 2 OF HR 6410)

H.R. 6410 reduces the amount one can set aside for retirement on a tax-deductible basis. Surely no one can complain that anyone able to provide a retirment income of more than $90,000 per year or to set aside in excess of $30,000 annually has need of a tax subsidy to help. H.R. 6410 still permits an accumulation of in excess of $1 million in a defined benefit plan and probably well in excess of that in a defined contribution plan. Certainly one cannot justify a tax subsidy to those who can accumulate more.[1]

What then are the likely arguments against H.R. 6410. We will probably hear that the well-to-do will continue to provide for their retirement, albeit at a greater tax cost and it will be the little guy that will suffer. This is pure nonsense, trickle-down revisited.

There are two possible bases for the assertion that H.R. 6410 will reduce benefits for the rank and file.

First, some may claim that unless the owner of a business can set aside as much as he or she can today—Annual contributions of $45,475 to a defined contribution plan or the substantially greater annual amount (perhaps $150,000 or more) that might be required to provide a pension of $136,425 per year—they will not be interested in a qualified plan. Thus, there will be no retirement security for the rank and file worker. I suggest that the tax benefits, even with H.R. 6410, are still overly generous. No one is going to pass them up because they once were entitled to more.

Alternatively, if I am wrong then we need to examine our approach—do we really have a cost-effective program or just trickle-down of the worst order. If tax benefits of the current magnitude must be provided to induce a little saving for the rank and file (In my experience it was not uncommon for well over 90 percent of the contributions, and because of bracket difference even more of the tax savings, to be allocated to the owner of the business) then perhaps we should forget the tax subsidy for private plans. Allocating the federal subsidy to social security might be far more productive.

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[1] Similarly, there would seem to be no valid argument against Sec. 8 of H.R. 6410 which limits the existing unlimited estate tax exclusion to $500,000. Given the unlimited marital deduction and the unified credit which will exempt, the first $600,000 of an estate from tax, it is hard to justify *any* additional estate exemption for pension benefits.

Secondly—opponents of H.R. 6410 might claim that if they are required to reduce contributions for themselves, they will reduce contributions for all others as well. For example, if an individual earning $180,000 wishes to contribute 45,000 for himself, the contribution rate will be 25 percent for all employees including himself. Thus, the contribution for an individual earning $20,000 would be $5,000 per year. If the maximum contribution is $30,000 the owner might change the rate of contribution to 16⅔ percent (16⅔ of 180,000 = 30,000). This would reduce the contribution of the $20,000 earner to $3,333.

This is possible under H.R. 6410 as it now stands but it is not a necessary result of the legislation. All that is required is to put a ceiling on the amount of compensation that can be taken into account for purposes of a tax subsidized qualified plan. A maximum contribution of $30,000 and a maximum percentage of 25 percent implies a desire to limit aid to replacement of the first $120,000 of earnings (25 percent × $120,000 = 30,000). Just as Social Security now limits coverage to $32,400, the tax system will not subsidize retirement savings to replace earnings over a certain point.

If compensation over $120,000 could not be taken into account any owner of the business who wished to contribute $30,000 for himself would have to contribute at the 25 percent rate for all participants. Under this approach HR 6410 will not result in reduced savings for rank and file employees.

The pension community has opposed a ceiling on compensation to be considered for qualified plan purposes. Although the failure to include such a ceiling in 1962 (when dollar limits were first imposed on pension contributions as part of HR 10) must have been an oversight, corrective legislation has been difficult. Only as part of ERISA in 1974 was an $100,000 ceiling established for plans benefiting the self-employed. But even this limit was raised to $200,000 last year as the professional community fought very hard and successfully to insure that the 1981 increase in the contribution limit to HR 10 plans *need not* benefit anyone but the owners of the business.

It is disingenuous to utilize a technical glitch in the Code which you have fought to keep there to argue against sensible legislation.

A ceiling on compensation is consistent with the purpose of the tax subsidy and with it HR 6410 need not and will not result in reduced savings for rank and file employees.

MORE BENEFITS FOR RANK AND FILE (§§ 4, 5, 6, 7 OF H.R. 6410)

The requirement that qualified plans not discriminate in favor of highly paid employees has not assured equal access to the special tax benefits. We need to get more rank and file employees into the plans and provide more vesting (i.e. nonforfeitable benefits) for those that do participate. We should also extend the non-discrimination requirement to all tax favored arrangements as required by § 7 of H.R. 6410.

Integration (§ 4)—The existing procedures for integrating or coordinating private retirement plans with Social Security are probably the primary hindrance to more adequate protection of low and moderate income employees. The justification for the tax subsidy to qualified plans must be that Social Security does not adequately replace pre-retirement earnings of the rank and file. A profit-sharing plan which makes contributions only for those earning in excess of $32,400 (the taxable wage base in 1982) obviously does not help low and moderate income people and to my mind is not deserving of a tax subsidy.

H.R. 6410 is helpful in reducing the permitted contribution to such a plan from 7 percent to 5.4 percent but I believe it is based on the wrong premise and in some circumstances it could aggravate the existing inequity. I would recommend that no plan be entitled to a tax subsidy unless it provides at least some benefit on the first dollar of compensation. Integration is valid as a means of providing more for the higher paid only if the plan assures adequate replacement for low and moderate earners.[2]

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[2] If this change were made there would be significantly less concern that elimination of the 1.4 rule would harm moderate earners. If the plan is working properly a defined benefit plan should provide adequate replacement.

The proposed safe harbor for defined benefit plans is one approach to this goal. The safe harbor, if it applied to defined contribution plans, would require a contribution of at least 2.7 percent for all employees if the plan desired to contribute 5.4 percent on earnings above the wage base. This is a better result than that achieved under the bill.

H.R. 10 LIMITS (§§ 5 AND 6 OF H.R. 6410)

Under the bill retirement plans established by professionals would be subject to one set of rules. This sensibly deters the race to incorporate to avoid the restrictions of HR 10. However, the professional community will certainly protest the extension of these conditions to plans established by professional corporations.

This raises two questions. Are these restrictions generally appropriate and if so is there any justification for limiting them to professionals as opposed to across the board application. There are differences between on the one-hand closely-held corporations, in general, and professional corporations, in particular and on the other large business. The owner of a closely-held business is in effect always fully vested. Moreover to the extent the owner of a business sets aside funds for himself there is a similarity to individual savings for retirement which for most of us is much less favorably treated. The only factor that distinguishes savings through a qualified plan is the provision made for rank and file employees. However, professional firms in particular have a small number of rank and file per each professional owner and their plans may come very close to individual saving for retirement. This is particularly true if the business ceases and the plan terminates at the retirement of the owner.

Thus, it is reasonable to make a special effort to insure a wider distribution of the tax benefits from plans established by professionals. Earlier vesting is one means of achieving this goal. Another would be to require a longer period of participation to earn full benefits.

If an owner of a business establishes a defined benefit plan when, for example, he is age 55 he will fully fund his benefit over 10 years if normal retirement age is 65. For an employee age 35, funding will be over 30 years. Thus the ratio of the contribution for the owner compared to the contribution for the employee will far exceed the ratio of their respective earnings. Further, if the business terminates when the owner retires, the employee will never earn a full pension and will earn a far smaller pension as a percentage of pay than the owner even though both have 10 years of participation. In addition employees who came and went before the plan was instituted will not earn any benefit. Again these concerns seem most serious for professional corporations where business continuity may depend upon the services of one individual.

In short there are good reasons to apply different standards to owners of a closely-held business than to others and to distinguish between professional corporations and other relatively small businesses. Moreover, the conditions H.R. 6140 would apply to professional corporations, particularly the requirements for earlier vesting and longer period of participation to earn full benefits from a defined-benefit plan, are consistent with the effort to seek more dispersion of the benefits of qualified plans. This does not mean that there are not other means, perhaps both more precise and more complex to accomplish these goals.

ELIMINATION OF ABUSE (§ 3 OF H.R. 6410)

If you borrow against your account in a profit sharing plan.

1. You have use of the money without paying tax.

2. You get an interest deduction for "borrowing" from yourself while at the same time deferring tax on the interest income. Thus, the higher the rate the better.

3. Since your account will be used to pay the loan, there will be no savings for retirement.

Even under the standards of our Internal Revenue Code this won't fly. Loans should certainly be treated as a current distribuion. In addition, if the goal is savings for retirement prohibition (or penalties) against early distribution by loans or otherwise is essential.

SUMMARY OF PRINCIPAL POINTS

1. The justification of favorable tax treatment of certain forms of compensation is to encourage their widespread use particularly by low and moderate income earners.

2. Action is needed to insure that tax favored plans provide benefits for more individuals. Non-discrimination requirement should be strengthened and uniformly applied to all tax-favored arrangements.

3. There is no justification for the subsidization of savings to provide retirement benefits of $135,000 per year or more or for retirement contributions in excess of $45,000 annually.

4. Limits on the amount of tax-subsidized benefits for high income individuals need not cause loss of benefits for the rank and file.

5. The rules for integrating qualified plans with Social Security should be modified—No plan should be entitled to special tax benefits if it limits coverage to earnings over the Social Security wage base.

6. The conditions applicable to retirement plans should not depend upon whether a business is incorporated or not.

7. At least some of the rules applicable to H.R. 10 plans should become more widespread. In particular, it is appropriate to take steps to assure that plans established by professionals will provide significant benefits for rank and file employees.

Chairman ROSTENKOWSKI. Mr. O'Farrell, you may proceed.

STATEMENT OF BRENDAN O'FARRELL, EXECUTIVE VICE PRESIDENT, HOWARD JOHNSON & CO.

Mr. O'FARRELL. Thank you for letting me come here today. I would like to correct a couple of typographical and transposition errors in my written testimony, and I will send that in before the deadline.

I would like to begin by first explaining that I am a consulting actuary with Howard Johnson & Co., a consulting firm in Seattle, Wash., and am representing that firm. We support the expressed objectives of the bill that Mr. Rangel outlined when he introduced it to the House.

I think we are afraid, after an analysis that we worked on literally night and day since the bill was introduced, that some provisions of the bill would have exactly the opposite of what Mr. Rangel intended the bill to do. The specific provisions that we feel uncomfortable with are the indexation of the wages on which benefits are calculated, the change in the aggregation rule for combination of defined benefit and defined contribution, the application of rules for self-employed persons to what are characterized as "personal service corporations," and most particularly the integration provisions as they are in the bill.

Again, let me reemphasize that we support the intentions. Yes, there are some abuses, and the present rules allow persons to circumvent the antidiscrimination intent established by Congress in 1942 and carried through to current day with various strengthening through the provisions of ERISA. Many of the other witnesses today have talked to you about what the problems with the bill are. I would like to present what I believe is empirical evidence that those problems exist and that the committee needs to be very careful in establishing the actual provisions of a bill that makes changes in rules as complex, particularly, as the rules on coordinating private pension plan with social security.

The overriding objective of our total retirement system, both social security and employer-sponsored public or private plans, is to see that every retired person receives an adequate retirement income. We think any change should be measured against that objective as well as the antidiscrimination objectives that Mr. Rangel has expressed.

Briefly, on the repeal of the COLA, we feel that with some of the projections we have made, there is a potential for an increased burden on social security to have to provide an increasing portion of total benefits, and that even though Mr. Halperin says that you could raise the limits periodically, I think you get some severe funding disruption that could also burden the risks that are placed on the Pension Benefit Guaranty Corporation. It has about all the risks it can handle right now.

Regarding the change in the aggregation rules: The best way in many employee benefit situations to get a combination of delivery of ultimate retirement income to career employees and reasonable accumulation of retirement benefit for short-service employees is through a combination of plans. The change in the 1.4 if accompanied by the reduction in the limitations proposed in the bill would directly impact almost 200,000 persons. Those are highly compensated persons. We are afraid, looking at the potential results and doing projections against the data base—incidentally the data that we have used is that which was developed on the characteristics of single-employer private plans for the President's Commission. It has been given to you, Mr. Chairman, yesterday, a good part of it, and more of it has been given to your staff on the Joint Committee on Taxation.

We are afraid that the fact of the matter is that a company that now sponsors two plans, one of which under the provisions of the bill would accrue no benefit at all for senior key employees, would result in a situation where a substantial number of those plans would terminate the supplemental plan that most benefits short, service low-income people.

On the integration rules, we believe that the intent of limiting the abuse in terms of producing a very substantial benefit for a high-paid person and what Mr. Halperin referred to as integrating out the rank-and-file employees would be corrected by the bill, but unfortunately, the contribution—I am talking specifically about defined benefit plans—the contribution-based approach to coordination of social security, which is a benefit-based system with defined benefit plans, would have the certain result of negating the vesting and participation standards established in ERISA, which are there to insure that short-service younger people receive a benefit. I hope you can all read that—referring to overhead projection. This is based on some of the projections that we have done against the data base looking at the typical defined benefit plan.

The problem with the approach to integration under the principal rule, the offset rule, is that the accruals, if you look at the green line that is the slope of accrual under a present plan that falls exactly within the mode range of all the existing single-employer private plans—that is the typical plan—if you amend that plan to comply with the provisions advanced under the bill, the accrual does not begin for a 35-year-old entering employment in 1983 at a $15,000 salary until age 49. If the employee has instead a $30,000 salary, the same pattern develops, and we feel that it is the fundamental approach of trying to coordinate a benefit-based system, two benefit-based systems, social security, and the defined benefit private plan, which results in this problem. For the short-service employee who works 10 or 15 years, the net effect of this could easily be that no benefit under the plan would accrue.

This chart illustrates the benefits accruing after 10 years of service—referring to overhead projection. The green bars are the present rule for various ages and salaries beginning in 1983 along the bottom axis of the chart. For the younger employees, those under age 45, the effect of the integration rule in the bill would be to eliminate the benefits on termination after 10 years of service regardless of vesting, and this is based on full 100-percent, 10-year vesting, which is 84 percent of all the plans that exist. I know that is not what is intended by the bill, but we are afraid that it is, in fact, the result.

I know I am running over my time, and I am sorry.

We believe that portions of this bill have an impact that is almost as great as that of ERISA. ERISA introduced a lot of requirements to the private pension system that have been beneficial. They have strengthened the adequacy of funding; they have insured that more benefits inure to the benefit of employees in general. This bill needs the same kind of consideration that went into ERISA, and you know there are still flaws with that. I think there are bills which have been introduced in Congress to correct some of those flaws. We are afraid that this bill as it is currently constructed could have disastrous consequences and quite the opposite result of what Mr. Rangel intends it to do.

[The prepared statement follows:]

STATEMENT OF HOWARD JOHNSON & CO., CONSULTANTS & ACTUARIES, PRESENTED BY BRENDAN O'FARRELL, EXECUTIVE VICE PRESIDENT, CONSULTING ACTUARY

Howard Johnson & Company
CONSULTANTS AND ACTUARIES
PENSION & PROFIT SHARING EMPLOYEE BENEFITS INCENTIVE & DEFERRED COMPENSATION EMPLOYEE COMMUNICATIONS

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June 8, 1982

Hon. Chairman Rostenkowski
and Distinguished Members
Ways and Means Committee
U.S. House of Representatives
Washington, D.C.

Re: The Pension Equity Tax Act of 1982
(H.R. 6410)

Ladies and Gentlemen:

Attached please find our statement including a brief analysis of the potential impact of certain provisions of the above proposed legislation.

The principal data on which our analysis is based was developed under a contract to the President's Commission on Pension Policy for an analysis of single-employer pension plans in the United States. Supplemental data is from published sources (primarily government studies) furnished by the Employee Benefit Research Institute and our own data on client retirement plans. You or your staff are welcome to share this data and discuss our methodology at any time.

We appreciate the opportunity of presenting our views to you on this important legislation.

Respectfully submitted,

Brendan O'Farrell

BOF:tjs

Attachment

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ANALYSIS OF THE POTENTIAL IMPACT ON SINGLE-EMPLOYER PRIVATE PENSIONS OF CERTAIN PROVISIONS OF THE PENSION EQUITY TAX ACT OF 1982 (H.R. 6410)

Page

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Letter of Transmittal

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I. EXECUTIVE SUMMARY

This section briefly summarizes the opinions and conclusions arising from our analysis of certain provisions of the bill, H.R. 6410. More detailed discussion, as well as specific results of a computer model forecast of the impact of certain provisions of the bill is contained in the following sections.

Although we generally agree with the expressed objectives of the bill, we believe that certain of its specific provisions would accomplish the opposite of its intent.

Based on our analysis, we believe that provisions of the bill, as drafted would:

1. deprive hundreds of thousands of lower and middle-income private sector workers of pension accruals on termination of employment prior to retirement;
2. cause the termination of, or cessation of contributions to, a substantial number of supplemental defined contribution plans which benefit rank and file employees;
3. result in increased pressure on both the Social Security System and the Pension Benefit Guaranty Corporation;
4. create substantial and unnecessary administrative costs associated with compliance which would further burden many employers in the current economy who have recently faced the costs of ERISA and MEPPA;
5. retard the growth of post-retirement, employer provided medical coverages for rank and file employees; and
6. unreasonably discriminate against individual employees on the basis of occupation or nature of business, thereby further restricting the benefits of staff employees.

II. INTRODUCTION

To say that the specific technical provisions of this proposed legislation, let alone the unusually short interval between its introduction and today's hearing, have come as a surprise to the private pension community would be an understatement.

Please let us state that we endorse the **intentions** of this proposed legislation which were expressed by Mr. Rangel in his introduction of this bill before the House on May 19. We respectfully submit, however, that several of the actual provisions of this bill will have a result which is directly opposite to both its expressed intent and the carefully developed historical congressional objectives of favorable tax treatment for employee benefit and retirement programs.

This conclusion is based upon the best data available nationally and as thorough an objective analysis as has been possible in view of the limited time available between May 19 and today's hearing.

The potential impact of certain provisions of this legislation is nearly as significant as that of ERISA itself. Accordingly, those provisions deserve and require the same level of thoughtful consideration on the part of Congress that preceded the passage of ERISA.

It has been said that **"for every complex problem, there is a solution which is simple, neat and usually wrong".**

There are indeed flaws and loopholes in the present law which permit some abuse. However, these flaws require surgery which is best performed with a scalpel; not with a cleaver.

III. BACKGROUND

A. Howard Johnson & Company

Howard Johnson & Company is an independent firm of consulting actuaries with offices located in Seattle, Portland and Los Angeles. The firm provides consulting and administrative services to approximately 350 corporate and governmental employers sponsoring tax qualified retirement plans covering from 16 to 17,000 employees. These plans cover an average of more than 1,000 participants.

Our ability to provide this analysis results in large part from our previous involvement in studies conducted for the President's Commission on Pension Policy.[1] All of the statistical analysis and model forecasting in connection with the Commission's survey of single-employer private pensions was performed by our staff, utilizing our computer systems. Additional published data and our own client files and experience were also employed in developing the following data and views.

It is important to note that the retirement plans served by our firm are true **employee benefit** plans, established to provide meaningful retirement income, as opposed to some plans which are created primarily as a vehicle for deferral of taxation. We believe (and the data shows) that the latter category of plans represents the smallest segment of the private pension system.

Please recognize also that we are opposing certain provisions of this proposed legislation which if enacted as proposed, would result in hundreds of thousands of dollars of immediate fee income to our organization.

B. Private Pensions and Retirement Income Adequacy

The private pension system in the United States has grown over the last 40 years to become one of the cornerstone sources of adequate retirement income for retired Americans. Studies conducted in 1979-80 for the President's Commission on Pension Policy demonstrate conclusively that private pension benefits represent the difference between a decent living standard and minimum subsistence or poverty for millions of retired private-sector workers.

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[1] Analysis of the Provisional, Financial and Demographic Characteristics of Small and Medium Sized Employer Sponsored Private Plans, December 1980, copy enclosed.

In 1940, just four years after the creation of Social Security, only 14.5% of the non-agricultural private work-force was covered by a private pension. In 1979, 60% of all private-sector workers over age 25 with one or more years of employment service enjoyed this coverage. Although, as a result of statutory extensions, coverage under Social Security has risen from 55% in 1940 to more than 90% today, the voluntary rate of growth of private pension coverage has been more than twice that of Social Security.

TABLE 1

GROWTH IN RETIREMENT COVERAGE
(% OF COVERAGE FOR SPECIFIC LABOR FORCES)

	1940	1950	1960	1970	'75	'77
SOCIAL SECURITY COVERAGE OF ALL PAID EMPLOYMENT	55[1]	65	88	87	90	90
FEDERAL EMPLOYEE RETIREMENT COVERAGE OF ALL FEDERAL EMPLOYMENT	APPROXIMATELY 100	100	100	100	100	100
STATE & LOCAL RETIREMENT COVERAGE OF ALL STATE & LOCAL EMPLOYMENT	NA	NA	82[2]	83[3]	NA	87
PRIVATE PENSION COVERAGE OF NON-GOVERNMENT WAGE & SALARY NON-AGRICULTURAL EMPLOYMENT	14.5	25.0	40.8	45.1	48.6	NA

[1] for year 1939
[2] for year 1962
[3] for year 1972

Source: *Economic Report of the President*, January 1980, Table B, 34. Social Security Bulletin, Annual Statistical Supplement, 1976, Table 7, Special Analysis of the Federal Budget 1981, Table 1-4, p. 288. Statistical Abstract, 1979, Table 543, p. 339. Social Security Bulletin, November 1977, p. 27.

PRESIDENT'S COMMISSION ON PENSION POLICY

TABLE 2

PRIVATE PENSION PLAN COVERAGE
(active workers, both full-time, and part-time, excluding self-employed)

	PRESIDENT'S COMMISSION ON PENSION POLICY HOUSEHOLD SURVEY 1979			DOL/SSA CURRENT POPULATION SURVEY		
	PERCENTAGE					
AGE, YEARS ON JOB, AVERAGE WEEKLY HOURS	ALL EMPLOYEES	MALE	FEMALE	ALL EMPLOYEES	MALE	FEMALE
TOTAL	42	51	32	43	50	31
UNDER AGE 25	27	33	20	19	22	15
AGE 25 AND OVER	47	56	36	52	60	38
ERISA STANDARDS (more than 1 year of service + 1000 hours)	58	64	48	61	67	50

Source: President's Commission on Pension Policy [illegible] Administration, 1979

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Despite this substanial rate of growth, the President's Commission correctly observed in its final report; **"the most serious problem facing our retirement system today is the lack of pension coverage among private sector workers".**

The private pension system owes its growth and development in large measure to congressional initiatives and policy which created tax incentives for the formation of such plans. In 1942, the Congress wisely recognized that the national interest was not served if the benefits arising out of such incentives flowed only to a few highly compensated persons. As a result, Internal Revenue Code of 1942 introduced a non-discrimination requirement with respect to private plans. This principle has been developed and refined through subsequent congressional and regulatory actions culminating in 1974 in the passage of the Employee Retirement Income Security Act (ERISA).

Although there is strong evidence suggesting that ERISA has, in fact, retarded the growth of private pension coverage in recent years, the bulk of its provisions are well-founded and contribute to the broadening and strength of the system. Of course, as in any legislation of such magnitude, ERISA does possess both technical and substantive flaws. Most of those flaws would be corrected as a result of bills proposed by Congressmen Erlenborn and Burton and Senator Nickles which are being further studied and refined; both in government and the private sector.

The principal objective of our total retirement system, including Social Security and both private and public employer sponsored pension programs, is to insure that every retired person in this nation enjoys an adequate standard of living.

Although opinions vary regarding a proper quantitative definition of adequacy, the President's Commission proposed, after 2 years of thorough study and reams of public testimony, the following objective standard of measurement:

". . . the replacement of pre-retirement disposable income from all sources is a desirable goal".

The following tables, taken from the Commission's final report to the President and Congress illustrate this objective in more quantitative terms:

See following Pages.

TABLE I

RETIREMENT INCOME TO MAINTAIN PRERETIREMENT STANDARD OF LIVING

MARRIED COUPLES RETIRING IN 1980 FOR SELECTED INCOME LEVELS

GROSS PRE-RETIREMENT INCOME	PRERETIREMENT TAXES		DISPOSABLE INCOME	REDUCTION IN EXPENSES AT RETIREMENT			NET PRE-RETIREMENT INCOME	POST RETIREMENT TAXES[4]		EQUIVALENT RETIREMENT INCOME	
	FEDERAL[1]	STATE & LOCAL[2]		WORK RELATED EXPENSES[3]	SAVINGS & INVESTMENTS			FEDERAL INCOME	STATE & LOCAL[2]	DOLLARS	RATIO
$ 6,500	$ 549	$ 29	$ 5,922	$ 355	0%	$ 0	$ 5,567	$ 0	$ 0	$ 5,567	.86
10,000	1,311	133	8,556	513	3	257	7,786	0	0	7,786	.78
15,000	2,550	310	12,140	728	6	728	10,684	0	0	10,684	.71
20,000	3,968	520	15,512	931	9	1,396	13,185	0	0	13,185	.66
30,000	6,986	1,061	21,950	1,317	12	2,634	17,999	53	10	18,062	.60
50,000	15,202	2,622	32,176	1,931	15	4,826	25,419	1,651	314	27,384	.55

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1. Federal income and social security (OASDHI) taxes.
2. Based on state and local 1978 income tax receipts which were 19% of federal income tax receipts. Does not include property taxes.
3. Estimated as 6% of disposable income
4. Post retirement taxes are on income in excess of social security benefits which are non-taxable. Retirees without social security benefits would need higher replacement ratios.

Source: Preston C. Bassett, Consulting Actuary, President's Commission of Pension Policy, 1980.

TABLE 2

RETIREMENT INCOME TO MAINTAIN PRERETIREMENT STANDARD OF LIVING

SINGLE PERSONS RETIRING IN 1980 FOR SELECTED INCOME LEVELS

GROSS PRE-RETIREMENT INCOME	PRERETIREMENT TAXES		DISPOSABLE INCOME	REDUCTION IN EXPENSES AT RETIREMENT			NET PRE-RETIREMENT INCOME	POST RETIREMENT TAXES^{4}		EQUIVALENT RETIREMENT INCOME	
	FEDERAL^{1}	STATE & LOCAL^{2}		WORK RELATED EXPENSES^{3}	SAVINGS & INVESTMENTS			FEDERAL INCOME	STATE & LOCAL^{2}	DOLLARS	RATIO
$ 6,500	$ 906	$ 97	$ 5,497	$ 330	0%	$ 0	$ 5,167	$ 0	$ 0	$ 5,167	.79
10,000	1,785	223	7,992	480	3	240	7,272	0	0	4,272	.73
15,000	3,259	444	11,297	678	6	678	9,941	0	0	9,941	.66
20,000	5,055	728	14,217	853	9	1,280	12,084	166	32	12,282	.61
30,000	8,926	1,429	19,645	1,179	12	2,357	16,109	1,077	205	17,391	.56
50,000	18,921	3,328	27,751	1,665	15	4,163	21,923	3,153	599	25,6775	.51

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1. Federal income and social security (OASDHI) taxes.
2. Based on state and local 1978 income tax receipts which were 19% of federal income tax receipts. Does not include property taxes.
3. Estimated as 6% of disposable income
4. Post retirement taxes are on income in excess of social security benefits which are non-taxable. Retirees without social security benefits would need higher replacement ratios.

Source: Preston C. Bassett, Consulting Actuary, President's Commission of Pension Policy, 1980.

The tables presented above show that an objective standard of retirement income adequacy may be achieved if, within our total system of retirement provision, we can deliver a range of ultimate after-tax replacement ratios of 86% in the lowest income categories to 51% in upper income categories.

The following table, excerpted from the Commission's study of private pension programs and up-dated to consider the impact of the Economic Recovery Tax Act of 1981 (ERTA) illustrates the relationship between pre-tax and after-tax replacement ratios:

TABLE 3

Relationship of Pre-tax and After-tax Replacement Ratios

----Pre-Retirement----		----Post-Retirement----	
Gross Pre-Tax Final Pay	After-Tax Income As a % of Gross Pay	After-Tax Objective As a % of Gross Pay	Pre-Tax Equivalent As a % of Gross Pay
Less than $15,000 [1].	85-90%	85-90%	@ 80%
$25,000 - $30,000	65-75%	60-70%	@ 60%
$40,000 and up	60-65%	50-55%	@ 50%

It is our opinion that any modification of the laws governing either privately or governmentally sponsored retirement programs should be evaluated on the basis of its relationship to the principal objective and measurement standard set forth above.

Only by such critera can we reasonably hope to achieve legislation which contributes to, rather than detracts from, the purposes recognized by Congress in 1942 and fostered through subsequent Congressional action over the last 40 years.

C. Objectives and Provisions of H.R. 6410

The laudable objectives of this proposed legislation were expressed by the Honorable Mr. Rangel in his statement to the House of Representatives in introducing the bill on May 19.

The following are exerpted from the Congressional Record and quote Mr. Rangel's introductory statement:

1. "A major objective of the bill is **to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees** in tax-subsidized pension and statutory fringe benefit plans." (emphasis added)

2. "A second major objective of the legislation is **to reduce the excessively high tax limits on tax-free accumulations under corporate pension plans.**" (emphasis added)

3. "Its is a central policy objective here, consistent with the thrust of the overall bill, that **the tax subsidy provided to such plans (those sponsored by 'professional service corporation') be distributed in an equitable and non-discriminatory fashion amongst the work force.**" (emphasis added)

4. "**This legislation by no means attempts to curtail or cap pension saving;** . . ." (emphasis added)

Provisions of the bill with which we are concerned would:

1. totally eliminate cost-of-living indexation of contribution and benefit limits under Section 415 of the Internal Revenue Code which could cause erratic patterns of funding and further burden Social Security and the Pension Benefit Guaranty Corporation;

2. create substantial and unnecessary administrative expense by requiring inclusion of the value of desirable post-retirement medical benefits in the benefit and contributions limits;

3. probably cause the termination of a large number of supplemental retirement plans by proposed modification of the 1.4 aggregation rule; thereby depriving thousands of rank and file employees of expected retirement benefits;

4. deprive long-service, lower and middle income participants of reasonable pension accruals, regardless of vesting, as a result of an overly-simplistic contribution based approach to coordination of private plan benefits with Social Security;

5. deprive the bulk of employees in the service sector of meaningful private plan benefits by the proposed extension of "self-employed" rules to a broad class of organizations characterized as "personal service corporations"; and

6. discriminate against individuals on the basis of occupation or nature of business.

IV. ANALYSIS OF POTENTIAL IMPACT

A. Repeal of Cost-of-Living Adjustments Under Internal Revenue Code Section 415

Under Section 2(b)(1) of the bill, indexation of the contribution and benefit limits ($45,475/30,000 and $136,425/90,000 respectively) prescribed by ERISA would be discontinued.

Mr. Rangel states in his introduction of the bill: "Discussion of COLA freezes and benefit program reductions should apply equally to government spending through the tax system". The proposed modification of the dollar limits is a reduction in benefits. In government sponsored programs, such as Social Security and Federal retirement systems, discussions of COLA have centered around short-term (1-2 year) freezes or modification of the level and/or methods of indexation. This bill, however, proposes a complete cessation of cost-of-living indexation in private pension plans.

We believe that such a step is counter to the established objectives of the systems to:

1. produce more meaningful, inflation protected (not proof) retirement income for the broadest class of workers; and
2. increase the sufficiency of funding and benefit security of private plans, as emphasized by Congress in ERISA.

Although a one or two-year freeze in the COLA adjustments would not seriously impact the bulk of covered workers, a complete repeal of such adjustments would, over time, result in a disparity between private sector plans and Federally sponsored programs which would shift increasingly greater burdens for retirement security to the Social Security System.

Additionally, periodic adjustments of the limits by Congressional action to recognize this problem would tend to disrupt the orderly patterns of funding in private plans. This could contribute ultimately to a greater drain on tax revenues and endanger the sufficiency of funding in plans faced with a "catch-up" situation.

We believe this issue merits more detailed examination by the Congress before any change in the COLA provisions of I.R.C. Section 415 is enacted.

B. Modification of the 1.4 Aggregation Rule Under Internal Revenue Code Section 415

Section 2(c) of the bill would reduce the combination of limits in the case of a participant covered under both a defined benefit plan and a defined contribution plan from the current 1.4 factor to a factor of 1.

After a careful examination of the potential impact of this provision, we believe that its implementation would result in two adverse conditions which are counter to the expressed purpose of the bill.

Based on our analysis of the data developed for the President's Commission on single-employer plans, there are approximately 60,000 persons nationally for whom the present 1.4 factor rule comes into play. These are principally owner-employees of small businesses and executives in larger corporate entities. A few are highly compensated non-management employees in specific industries. It is important to note that in the case of small business owners, plans cannot be afforded until the business has existed for many years and achieved financial stability. By that time, the owners are approaching retirement age and substantial contributions are needed to afford them an equitable level of retirement income in relation to that provided for their employees.

Approximately 30% of all companies sponsoring any type of qualified plan sponsor both a defined benefit plan and a defined contribution plan, covering some or all of the same employees. This percentage has been increasing over the past twenty years. The reason for this trend is that the most effective delivery of both ultimate retirement income for career or long-service employees and accumulation of reasonable pension accruals for shorter-service employees is often accomplished through a combination of the two plan forms. Businesses compete in a labor market where retirement and capital accumulation benefits must be attractive to all classes of employees; young and old as well as career and shorter-service persons.

Adoption of the proposed change in the 1.4 rule to a rule of 1 would result in a direct revenue gain to the Treasury estimated at approximately 250 million dollars for 1984. This direct gain estimate is attributable only to those 60,000 persons for whom the change would result in lesser future deductible contributions. However, the practical result would be that, in the case of some 40,000 companies, no contribution or benefit could accrue to the top key employees under one of two presently sponsored plans.

Question: Will companies continue to maintain two plans when only one affords any benefits to senior key employees?

We believe the obvious answer in a majority of cases is NO. If only half the affected companies discontinue supplemental plans under which no further benefits accrue to senior key employees, approximately 350,000 lower and middle-income workers will be deprived of further expected benefits under existing plans.

Although, as Mr. Rangel stated, "this legislation by no means attempts to curtail or cap pension savings", we believe that passage of this provision would have precisely that result.

A second adverse impact of this provision is the level of direct administrative expense associated with plan re-design and on-going compliance measurement. Our analysis shows that the incremental administrative cost associated with this provision would exceed $200 million in the year of enactment and tens of millions of dollars in subsequent years.

C. Inclusion of Post-Retirement Medical Benefits in the I.R.C. Section 415 Dollar Limits.

Section 2(e) of the bill would require that, in computing individual benefits and/or contributions under the Section 415 dollar limits, the "value" of any post-retirement medical (or other statutory) benefits provided by the employer would be subtracted from the $30,000 and/or $90,000 limits in order to determine the remaining allowable contribution or benefit for the pension plan(s).

We believe the enactment of this provision would be extremely detrimental to hundreds of thousands of employees.

Only in the last few years have any but the very largest employers provided post-retirement medical or death benefits. In most cases, the death benefits are modest; usually only enough to cover last expenses and debt settlement. Post-retirement, employer-sponsored medical coverage supplements Medicare, thereby relieving some of the pressure on that system. Additionally, such coverage protects retired persons in ill-health from the total depletion of assets accumulated over a lifetime of working. Certainly, the provision of these benefits should be encouraged by Congress. We believe that the increasing trend of providing these benefits would be halted if this provision were enacted.

In most companies of any size, the administrative cost of measuring these benefit values for inclusion in on-going 415 pension compliance tests would be a significant sum in relation to the cost of financing the medical and/or death benefits.

For example, in a small sample of 3 of our own client companies covering 16,000 employees with approximately 1,500 current retirees, the incremental cost of program modification and on-going compliance testing would amount to more than 30% of the employer's cost of providing retiree medical coverage.

If the intent of this provision is to prevent excessive tax-subsidzed funding of self-insured medical coverage, a more direct approach might be to set specific limits on post-retirement reserve amounts and require certification of funding by an enrolled actuary on the basis of "reasonable" actuarial assumptions.

Compliance measurements for pension plans alone are already complex enough that addition of ancillary benefit values for retiree medical benefits could prove unduly burdensome and discourage future establishment of these plans. Such a disincentive could deprive hundreds of thousands of lower and middle-income retirees of needed coverage.

D. Modification of the Rules Under Which Private Plus Benefits are Coordinated with Social Security

Although several provisions of H.R. 6410, including those discussed above, would have adverse consequences, the provisions of Section 4 regarding integration of private plans with Social Security would spell disaster for many private sector plan participants and drastically increase the burden on the Social Security System.

The coordination of private systems with Social Security is a technically complex issue. In order to understand the basis of integration, one must be thoroughly familiar with the operation of Social Security contributions and benefits. The following is a summary of key points:

1. The benefits delivered by Social Security expressed as a percentage of accustomed working wages are much greater for lower income retirees than for middle and upper income employees. This is not a criticism but a statement of fact. Social Security is a system of transfer payments between both generations and income levels. The following table illustrates this point.

TABLE I-3
Age 65 Social Security Pretax Replacement Rates—1979

	Single Worker	Worker with Dependent Spouse
Maximum Covered Wage Earner	25%	38%
Average Covered Wage Earner	44	65
Full-Time Minimum Wage Earner	57	85

Source: U.S. Department of Health and Human Services, Advisory Council on Social Security, *Social Security Financing and Benefits* (1979), p. 59.

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*The Social Security minimum benefit has been eliminated for all persons retiring after January 1, 1982.

2. A retired worker whose contributions to Social Security have been three times greater than another person retiring in the same year will receive a benefit which is only 32% greater.

3. Employees and their employers each pay one half of the total Social Security tax amount.

The principle underlying coordination of private plans with Social Security recognizes the subsidy of lower paid workers by employers and higher paid workers implicit in the Social Security benefit formula.

The present integration rules were carefully developed by the Internal Revenue Service after extensive analysis. These rules were structured in relation to Social Security as it existed in 1971. The Social Security law has been significantly amended three times since 1971, while the integration rules have remained unchanged. The result is that minor technical flaws have developed in the coordination of Social Security and private plans. In addition, the present rules are indeed more complex than necessary. However, these minor difficulties are not solved by the radical and simplistic approach to integration proposed in this bill.

In order to analyze the impact of the integration rules contained in the bill, we have constructed a computer model which compares the actual delivery of benefits under typical private plan formulas operating under the present rules with those plans modified to comply with the proposed rules. The "typical" plan formulas are derived from the data base on single employer plans developed for the President's Commission.

Private defined benefit plans are integrated under two basic methods:

1. Offset methods, where a formula based on service and compensation is reduced by a portion of the individual's Primary Insurance Amount under Social Security (the maximum allowable offset approximately corresponds to the one-half of total Social Security benefits financed by employer contributions); and

2. Step-rate methods, where different percentage formulas are applied to individual compensation above and below the Average Monthly Wage Base under Social Security.

The most typical range of offset formulas in existing private plans provides a percentage of pay between 1% and 2½% for each year of service reduced by a **corresponding** percentage of the Social Security Primary Benefit.

The following table shows the comparison of benefits delivered under an existing plan providing for benefits equal to 2% of final pay per year of service up to thirty years reduced by 2% of PIA per year of service up to thirty years to those which would result if that plan were amended to comply with the proposed OASDI contribution based offset rule.

See following Page.

COMPARISON OF RETIREMENT BENEFITS UNDER PRESENT AND PROPOSED OFFSET INTEGRATION METHODS AT AGE 65

			Present Rule			Proposed Rule		
1983 Entry Age	RET Age	1983 Salary	Formula Benefit	[1]Offset Amount	[3]Net Plan Benefit	Formula Benefit	[2]Offset Amount	[3]Net Plan Benefit
25	65	$ 833	$4,852	$2,036	$2,816 (77%)	$4,852	$2,717	$ 2,135 (68%)
25	65	1,667	9,704	2,976	6,728 (73%)	9,704	5,433	4,271 (57%)
35	65	1,250	4,064	1,574	2,490 (76%)	4,064	1,539	2,525 (76%)
35	65	2,500	8,128	1,996	6,132 (70%)	8,128	2,899	5,229 (64%)
45	65	833	1,009	468	541 (67%)	1,009	345	664 (72%)
45	65	1,667	2,017	693	1,324 (60%)	2,017	691	1,326 (60%)
45	65	3,333	4,034	771	3,263 (51%)	4,034	1,030	3,004 (49%)
55	65	833	282	140	142 (60%)	282	87	195 (64%)
55	65	2,083	704	183	521 (41%)	704	219	485 (40%)
55	65	4,167	1,408	221	1,187 (33%)	1,408	272	1,136 (32%)

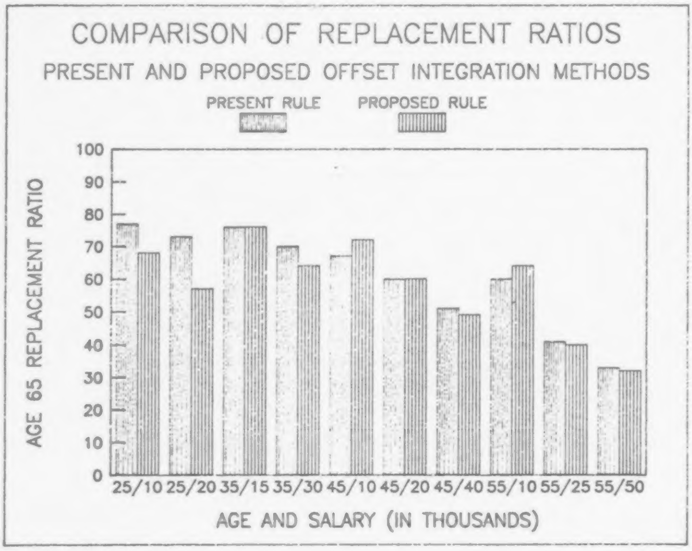
1. Assumes proportional offset against Social Security P.I.A. with 100% work-force participation from age 25 to age 65.

2. OASDI tax amount projected to age 65 at 8% interest and converted to monthly straight life benefit at 5% interest and 1971 Group Annuity Mortality.

3. Total pre-tax replacement ratio including plan benefit and social security P.I.A. shown in parenthesis.

Note that the benefits and total replacement rates for long-service, lower and middle income participants are reduced under the proposed rule in relation to the benefits and total replacement ratios for older short-service participants at all income levels.

The following chart provides a graphic comparison of total replacement ratios at age 65 for the above example:



The above example illustrates the discrimination inherent in the proposed rules against long-service lower and middle-income participants. An even more significant deficiency occurs when the accrual of benefits on termination before retirement is compared.

Two of the most important provisions of ERISA established statutory minimum requirements for participation and vesting in private plans. These rules were created to insure that younger and short-service employees who terminated employment after several years of plan participation, but prior to retirement, would be entitled to receive an accrued benefit from the plan in respect of their service.

Our analysis shows that the proposed H.R. 6410 integration rules could completely negate the participation and vesting requirements of ERISA and deprive hundreds of thousands of terminating employees of any private plan benefits.

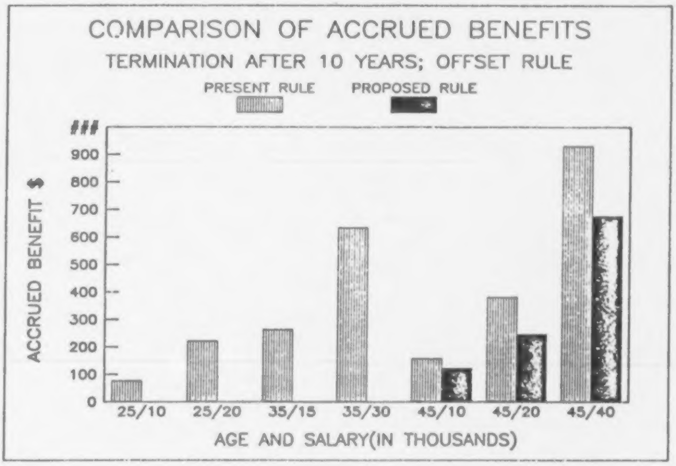
The following table compares accrued benefits at termination after 10 and 15 years of employment for the same plan example used on the previous page:

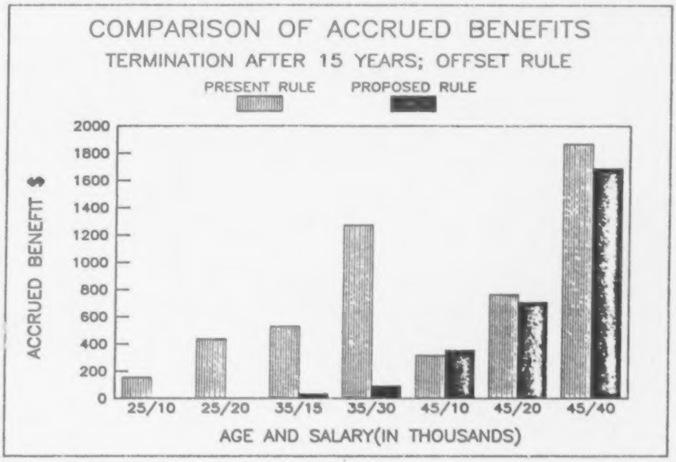
[1]COMPARISON OF ACCRUED RETIREMENT BENEFITS ON TERMINATION AFTER 10 AND 15 YEARS SERVICE UNDER PRESENT AND PROPOSED OFFSET INTEGRATION METHODS

			Present Rule		Proposed Rule	
1983 Entry Age	Age at Term	1983 Monthly Salary	10 Years Service	15 Years Service	10 Years Service	15 Years Service
25	35/40	$ 833	$ 77	$ 156	$ 0	$ 0
25	35/40	1,667	222	437	0	0
35	45/50	1,250	264	530	0	31
35	45/50	2,500	635	1,276	0	90
45	55/60	833	158	317	122	353
45	55/60	1,667	382	767	246	706
45	55/60	3,33	931	1,870	676	1,688

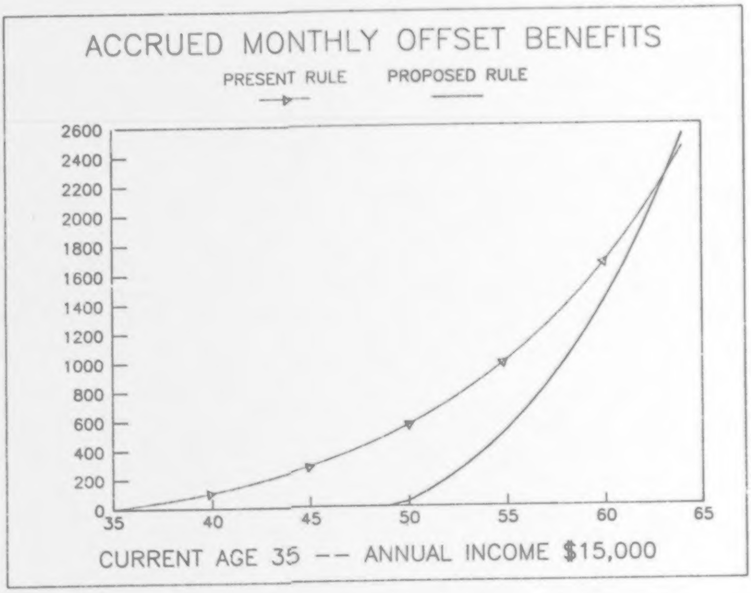
1. Assumes full vesting after 10 years service which corresponds to 84% of all existing plans.

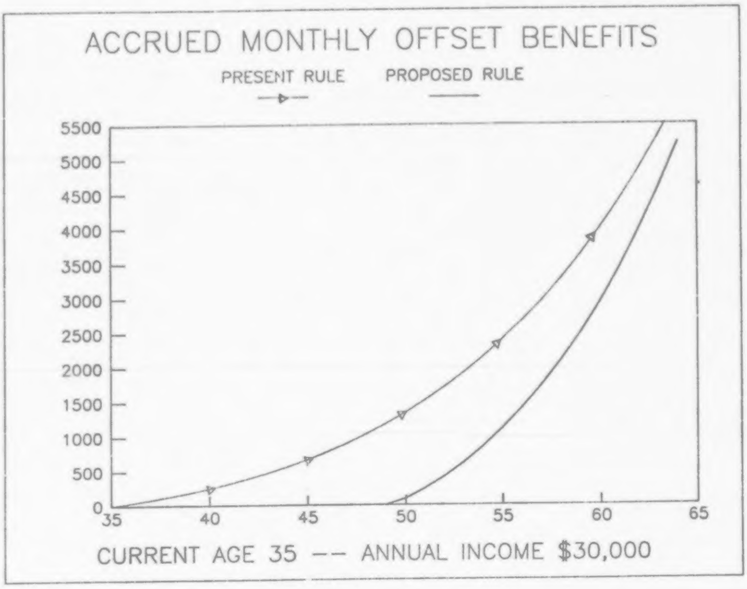
The following charts show a graphic presentation of the above table:


COMPARISON OF ACCRUED BENEFITS
TERMINATION AFTER 10 YEARS; OFFSET RULE
PRESENT RULE
PROPOSED RULE
ACCRUED BENEFIT $
###
900
800
700
600
500
400
300
200
100
0
25/10
25/20
35/15
35/30
45/10
45/20
45/40
AGE AND SALARY(IN THOUSANDS)


COMPARISON OF ACCRUED BENEFITS
TERMINATION AFTER 15 YEARS; OFFSET RULE
PRESENT RULE
PROPOSED RULE
ACCRUED BENEFIT $
2000
1800
1600
1400
1200
1000
800
600
400
200
0
25/10
25/20
35/15
35/30
45/10
45/20
45/40
AGE AND SALARY(IN THOUSANDS)

To further illustrate this deficiency, the following two graphs show the accrual of benefits over a thirty-year career from ages 35 to 65. These graphs compare present and proposed rule accruals for two persons entering the above described plan at age 35 in 1983 with starting annual salaries of $15,000 and $30,000.





Note that in both cases no accrued benefit arises under the proposed rule until age 50, but, as shown in the preceding table, the disparity is even greater for the lower-paid person between ultimate benefits under the two rules.

A contribution based method of coordinating private defined benefit plans with Social Security will not allow reasonable, non-discriminatory program design.

The typical step-rate formulas in private plans provide a range of benefits equal to between .5% and 1.5% of compensation at or below the "Social Security Average Monthly Wage" and between .25 and .8% of compensation above the average wage base.

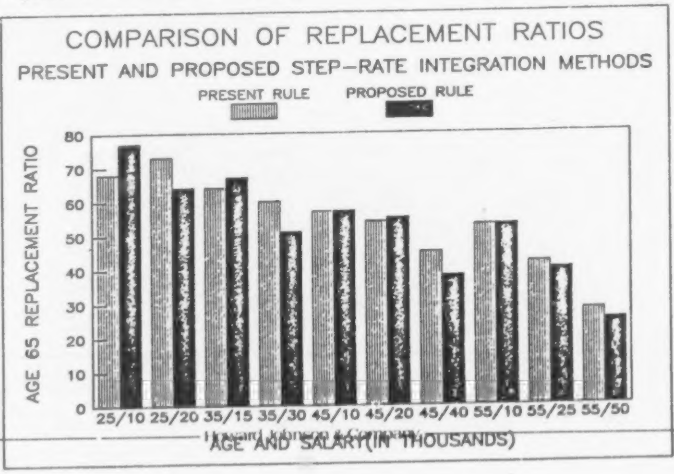
Section 4 of H.R. 6410 would include a new subsection (l)(4)(a) of I.R.C. Section 401 under the title "1-2-1 safe harbor for defined benefit plans". Our analysis shows that, like the basic proposed integration rule, this harbor is anything but safe. In fact, this proposed alternate rule is an arbitrary method of integration under a step-rate formula which bears almost no relationship to the benefits of Social Security.

In examining the results of this alternative, we compared a number of typical private step-rate plans to comparable formulas which would meet the 1-2-1 test. Presented here are two of those comparisons.

	Plan Set 1	Plan Set 2
PRESENT FORMULA:	.75% of compensation below the wage base, plus 1.5% of compensation above the wage base, all multiplied by years of service.	1.15% of compensation below the wage base, plus 1.45% of compensation above the wage base, all multiplied by years of service.
H.R. 6410 ALTERNATE:	.75% of compensation up to $30,000, plus 1.5% of compensation between $30,000 and $60,000, plus .75% of compensation above $60,000, all multiplied by years of service.	.67% of compensation up to $20,000, plus 12% of compensation between $20,000 and $60,000, plus 1.1% of compensation above $60,000, all multiplied by years of service.

Under the first plan set for comparison, the proposed $30,000 and $60,00 break-points are simply substituted for the Average Monthly Wage with no change in the benefit percentages. In the second set, we have attempted to design a formula under the proposed rule which results in benefits now anticipated under the current plan. As the following data shows, that objective is not possible under the proposed 1-2-1 rule.

The following table and chart show the comparison of benefits and ultimate replacement rates under plan set 1:



Howard Johnson & Company

COMPARISON OF RETIREMENT BENEFITS
UNDER PRESENT AND PROPOSED INTEGRATION RULES
AT AGE 65: STEP-RATE FORMULA AND "1-2-1" RULE

			Present Rule		Proposed "1-2-1" Rule	
1983 Entry Age	Age At RET	Projected Monthly	Accrued Monthly	Age 65 Total Replacement	Accrued Monthly	Age 65 Total Replacement
25	65	$ 833	$2,426	68%	$3,176	77%
25	65	1,667	7,136	73%	5,602	64%
35	65	1,250	1,896	64%	2,086	67%
35	65	2,500	4,944	60%	3,610	51%
45	65	833	378	57%	381	57%
45	65	1,667	1,078	54%	1,131	55%
45	65	3,333	2,591	45%	1,888	38%
55	65	833	106	53%	106	53%
55	65	2,083	413	42%	341	40%
55	65	4,167	941	28%	716	25%

Note the disparity of result between younger and older employees at the same salary levels. The proposed rule would deprive long-service workers at average income levels (see 25/20) of benefits delivered under the current rules.

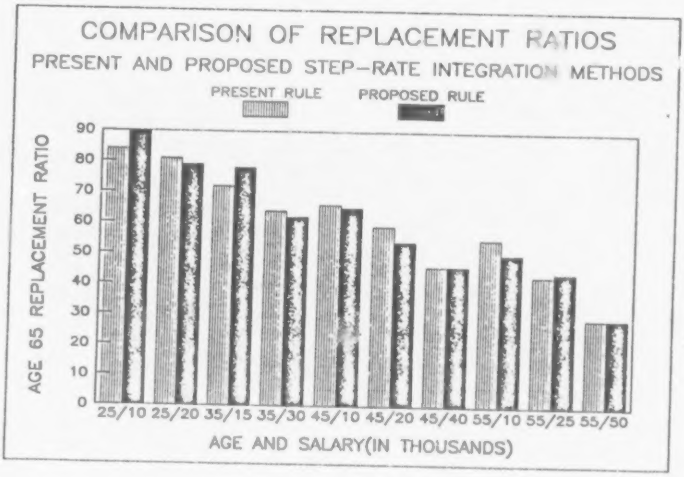
The next table and chart show the same comparison under plan set 2:

COMPARISON OF RETIREMENT BENEFITS
UNDER PRESENT AND PROPOSED INTEGRATION RULES
AT AGE 65: STEP-RATE FORMULA AND "1-2-1" RULE

			Present Rule		Proposed "1-2-1" Rule	
1983 Entry Age	Age At RET	Projected Monthly	Accrued Monthly	Age 65 Total Replacement	Accrued Monthly	Age 65 Total Replacement
25	65	$ 833	$3,720	84%	$4,469	93%
25	65	1,667	8,353	81%	8,027	79%
35	65	1,250	2,485	72%	2,919	78%
35	65	2,500	5,432	64%	5,154	62%
45	65	833	580	60%	564	65%
45	65	1,667	1,288	59%	1,565	54%
45	65	3,333	2,751	46%	2,674	46%
55	65	833	162	55%	94	50%
55	65	2,083	464	43%	482	44%
55	65	4,167	975	29%	1,002	29%

Present Benefit Formula: 1.15% of base + 1.45% of excess

H.R. 6410 Formula: .67% less than or equal to 20,000 + 2% greater than 20,000, less than or equal to 60,000 + 1.1% greater than 60,000.



This second example further illustrates the problems which would arise from this legislation. Looking at the graph for ages 45 and 55 at a $10,000 1983 salary, you can see that lower-paid, short-service employees (primarily women) would be adversely affected by enactment of these provisions. At the same time, in order to provide adequacy target levels of retirement income to longer-service, middle-income persons, it would be necessary to provide excessive benefits to long-service, lower-paid employees.

With the enactment of ERISA, Congress recognized the importance and complexity of this area and forbade any changes in integration rules until a detailed analysis had been completed. Such analysis has not been completed and this issue deserves a much more technically sound approach than is evidenced in H.R. 6410.

E. Extension of Self-Employed Rules to "Personal Service Corporations"

H.R. 6410 proposes to impose the limits and restrictions now applied to self-employed persons on "personal service corporations".

Many service sector organizations which would fall under the arbitrary definitions contained in Section 5 and 6 of the bill employ dozens or hundreds of persons and sponsor retirement programs for precisely the same reasons that very large industrial companies do; to attract and retain long-term quality employees.

Enactment of these provisions of the bill would:

1. discriminate against individuals by reason of their occupation or the nature of their company's business;
2. discriminate unfairly against smaller businesses in the service sector;
3. substantially reduce the rate of formation of new plans and, quite likely, cause a large number of plan terminations, which would deprive rank and file employees of expected pension income; and
4. result in hundreds of millions of dollars of administrative expenses which many businesses can ill-afford in the current economy.

F. Administrative Cost Impact

As part of our analysis, which began with a request from Congressional staff members for revenue estimates in connection with the proposed changes to I.R.C. Section 415, we have computed a conservative estimate if the bill were enacted as introduced. This estimate is based on survey data regarding professional fees, the PCPP Single-employer data base, and additional published data on the very largest companies. The amounts shown in the table below include only:

1. direct, hard-dollar expenses for legal, actuarial and administrative charges; and
2. direct costs of reproduction or printing to redistribute required disclosure information to covered employees.

No amount is calculated or included for internal corporate expenses of management time, modification of computer systems or procedures, and employee communications. Additionally, these figures disregard the very strong probability of wholesale plan terminations resulting from the enactment of this legislation. As a general rule, the administrative cost of terminating a plan is approximately 2½ times the cost of establishing a similar plan.

The following table shows the direct administrative costs associated with this bill for 1984-1986:

FEDERAL FISCAL YEAR

(Millions of dollars)

	H.R. 6410 Administrative Cost Impact			
	1984	1985	1986	3-Year Total
Defined Benefit Plans	$448.9	$ 98.6	$103.5	$ 651.0
Defined Contribution Plans	386.1	79.1	83.1	548.3
TOTAL	$835.0	$177.7	$186.6	$1,199.3

This is a considerable and unwarranted burden to impose on business in the current economic climate. Also, it represents an additional drain on Federal Revenues as the costs will reduce taxable income.

APPENDIX A

Sources of Data

Data on which this analysis is based has been taken from the following sources in addition to those noted earlier:

1. The Bankers Trust Company
   - a. 1980 Corporate Pension Plan Study
   - b. 1977 Study of Thrift and Savings Plans
2. The Employee Benefit Research Institute
   - a. Retirement Income and the Economy: Policy Directions for the 80's (1981)
   - b. Coverage and Benefit Entitlement (1981)
   - c. Income Levels and Adequacy (1982)
3. Employee Retirement Income Security Act of 1974 with Official Legislative History; American Society of Pension Actuaries, 1977.
4. Howard Johnson & Company
   - a. Data base of client retirement plans (not published)
   - b. Survey of Employee Benefit Plans in 65 of the largest 200 National Banks (data derived from published and non published sources)
   - c. Data on Employee Benefit Plans of Substantial Private Employers in the Western United States. (data derived from published and non-published sources on employer sponsored plans covering more than 1,000 persons)
5. Joint Economic Committee, Congress of the United States, Special Studies on Economic Change, Volume 8, Social Security and Pensions: Programs of Equity and Security, 1980
6. The President's Commission on Pension Policy
   - a. Final Report: Coming of Age: Toward a National Retirement Income Policy (1981)
   - b. Analysis of the Characteristics of Private Pensions (short title, copy attached)
7. U.S. Social Security Administration
   - a. Social Security Bulletins (1978-1981)
   - b. Social Security Bulletin Annual Statistical Supplement, 1977-79
8. The Wyatt Company Surveys of Retirement Plans in the 50 Largest Industrial Companies.

APPENDIX B

Assumptions and Methodology

This analysis has been based on the aforementioned data and on a computer model forecast of the impact on "typical" private pensions of the Social Security integration provisions of the bill compared to the operation of such plans under present rules. The economic assumptions underlying our model were established after consultation with staff of the Joint Committee on Taxation, U.S. Congress.

Estimates of administrative cost impact are based on data regarding the level of legal, administrative, actuarial and consulting fees associated with certain design and administrative tasks for various types and sizes of plans; as well as data on the total universe of private plans and the PCPP Analysis of Private Plan Characteristics.

Following are the specific assumptions underlying our model forecast:

1. Work-force participation. It is assumed that each person in the hypothetical employee population participates in the work-force from age 25 to retirement and is continuously covered by Social Security.

2. Social Security: All projections of Social Security covered wages and benefits are based on the current law. These projections assume no increase in FICA tax rates beyond those already called for in the present law.

3. Private Pension Plan Formulas: The benefit formulas chosen are those of actual plans and fall within the mode range of formulas for all existing plans of the type being compared.

4. Economic Assumptions:

(a) Price Inflation:	5% per annum
(b) Wage Inflation:	
(1) Index base:	5% per annum
(2) Salary Increases:	6% per annum
(c) Investment Return	
(1) Pre-retirement:	8% per annum
(2) Post-retirement:	5% per annum
(3) Single-rate Equivalent at age 35:	6.2% per annum
(d) Mortality:	1971 GAM, 60% male 40% female, projected on scale "c".

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give my life trying to help someone than to have to give my life looking down a barrel at them." A short time later, David Crozier died in an airplane accident. His message, however, lives on. Even as David Crozier sought to find a peaceful means of addressing the world's problems, so too should we.

In recent weeks there has been increasing talk in this House and in this country about the nuclear arms race and the danger of nuclear war. Much of the debate has centered on the proposed nuclear freeze and the resumption of strategic arms reduction talks.

Arms control, or course, is important. Very important. But we must also seek other means of making nuclear war unthinkable. Even old cold-war warriors like Nixon and Kissinger recognized the importance of establishing a "web of relationships." They were right. We need all kinds of commercial, cultural and athletic relationships between the Soviet Union and the United States. We need to establish broader people-to-people contacts and interests. We can sell them grain and nonsensitive technology that they would get from other countries anyway. I would love to see the Soviets begin to get accustomed to good old American steaks and fried chicken.

Until the Afghanistan invasion, we cooperated with the Soviets in athletics. In the past, we have had joint space missions, exchanges of ballet and drama companies and other common endeavors. We need to build more such bridges of understanding.

We must stop treating the citizens of the Soviet Union as some kind of subhuman species and suggesting that they do not care about wiping out 100 million of their people if they can get 105 million of ours.

We are all sharing this planet together and we have to work together if we are to save it. We have to recognize our common interests. Lyndon Johnson found a way to get through to Kosygin at the Glassboro Summit—they talked about their children and their grandchildren. Jimmy Carter did the same thing when he brought Begin and Sadat together at Camp David; when breakup was near, he talked about their children and their interest in peace.

So let's get busy building more bridges of understanding. The resolution that I am introducing today would help to build one more bridge of understanding. It calls for the creation of a United States-Soviet youth exchange program. It would be administered by a joint United States-Soviet Exchange for Peace Commission to be composed of civic, educational and cultural leaders from both countries. It would be financed by both government and private-source contributions. The program should aim at an initial enrollment of 2,000 young people from both countries. Half of those young people should come from the families of prominent civic, educational, cultural, and political leaders. Finally, there should be some provision requiring a widespread geographical distribution of the participants.

Would such a program stop a nuclear war? Perhaps not. It would, however, help to make nuclear war "unthinkable" for this generation and future generations to come. It is, I think, a small but important step toward genuine and lasting peace between our two countries. I urge my colleagues to join me in support for this initiative.●

THE PENSION EQUITY TAX ACT OF 1982, H.R. 6410

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from New York (Mr. RANGEL) is recognized for 10 minutes.

● Mr. RANGEL. Mr. Speaker, today I am introducing H.R. 6410, the Pension Equity Tax Act of 1982. The legislation would make a number of important changes in the tax treatment of employee benefit plans. A major objective of the bill is to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans.

A second major objective of the legislation is to reduce the excessively high tax limits on tax-free accumulations under corporate pension plans. Present law permits employer deductions for the funding of two types of corporate pension plans—defined contribution plans and defined benefit plans.

The current law limit for tax-deductible contributions to a defined contribution plan—for example, a profit-sharing plan where an employee's benefit is the balance of an account—is $45,475. In the case of a defined benefit plan—a pension plan specifying a stated benefit upon retirement, often based on pay and length of service, and where the employer funds the plan to meet that benefit obligation—the law permits tax-deductible contributions sufficient to fund an annual benefit at age 55 of $136,425. Both the defined contribution and defined benefit plan limits are adjusted annually by a cost-of-living factor.

At a time when the Congress is considering significant reductions in direct Government expenditures in a variety of entitlement and discretionary grant programs, I do not believe we can in fairness ignore the indirect tax expenditure side of Government subsidies. Discussions of COLA freezes and benefit program reductions should apply equally to Government spending through the tax system.

I would like to briefly summarize the major provisions of the Pension Equity Tax Act of 1982 for the RECORD.

The legislation would amend current law with respect to contribution and benefit limits on qualified pension plans in several ways.

First, the bill reduces the deductible limits from $45,475 and $136,425 to $30,000 and $90,000. This reduction maintains the present 3-to-1 ratio of defined benefit-to-defined contribution plans.

Second, the bill repeals the annual cost-of-living indexing of these limits.

Third, in cases where there is provided both a defined benefit plan and a defined contribution plan, the current law allowable ratio of 1.4, or 140 percent, of the separate plan limits would be reduced to 1.0. This reflects what I believe is the correct policy result; that is, the law should not allow a disregard for those limits merely because benefits are provided under two types of plans rather than one. I think it is important to point out that, while the legislation reduces the allowable section 415 limits, it fully preserves all the accrued benefit rights of individuals who have earned more than the new limits before 1984.

Fourth, the bill provides that if the defined benefit plan provides benefits prior to age 65—versus age 55 under current law—the $90,000 limit is reduced to reflect the earlier retirement age.

The bill includes provisions that would extend the Keogh plan rules with respect to loans to key employees under corporate plans. Loans from a corporate pension plan to a key employee—officers, 5 percent owners, highly paid—would be treated as a distribution from the plan and be considered as ordinary income to the employee.

A very important provision of the legislation deals with the coordination or "integration" of private pension plans and social security. Under present law some would argue that the tax qualification rules for pension plans allow excessive reductions of plan benefits or contributions for rank-and-file workers in recognition of employer-provided social security benefits. The bill rationalizes this coordination with simpler, but more precise, rules and limits employer plan reductions to no more than employer-attributable contributions to social security for the employee. The legislation also provides an alternative, simple safe-harbor test for integrating defined benefit plans.

A present law problem addressed by this bill involves the disparity in contribution limits for plans covering self-employed individuals, Keogh plans, and those for plans covering only employees, typically, corporate employees. The $30,000 difference today provides a purely tax-motivated incentive for partners and sole proprietors to incorporate. In light of the reduction to $30,000 in the defined contribution limits for employees I am today proposing, the bill addresses this parity issue in a responsible fiscal and policy manner by raising the deductible limits for Keogh plans to $30,000.

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Hand in hand with this change, however, the legislation would require that professional service corporations come under the present law rules applicable to self-employed plans. Among other things, these rules set minimum participation standards, require immediate vesting, and establish certain distribution limits and loan prohibitions. It is a central policy objective here, consistent with the thrust of the overall bill, that the tax subsidy provided to such plans be distributed in an equitable and nondiscriminatory fashion amongst the work force.

This nondiscrimination policy is embodied in another provision of the bill which applies uniform nondiscrimination standards to tax subsidized statutory employee fringe benefit plans. A number of these fringe benefits, from health insurance to van pooling, are provided for in the Internal Revenue Code. The bill would establish a simple mechanical test for testing whether a plan discriminates in favor of key employees. In addition, the bill would require that where a plan fails the discrimination test only the key employees would recognize income on their pro rata share of the benefits.

Finally, the bill places a limit on the estate tax exclusion for annuities paid to a beneficiary under retirement programs. This is an unlimited exclusion under current law and the bill would place a cap on that exclusion at $500,000.

Mr. Speaker, as I noted earlier, this important piece of legislation has two principal objectives.

It broadens the base of those being asked to accept benefit reductions through Government spending cuts by including those who substantially benefit through tax expenditure Government spending. Also as a matter of policy, I believe that the $30,000 and $90,000 amounts for tax-deductible pension plans are entirely rational and defensible limits for Government involvement in employee plan development. This legislation by no means attempts to curtail or cap pension plan saving; however, the efficiency and equity of Government expenditures for pension savings beyond the levels set in this bill must be seriously questioned.

Our current tax system provides a number of generous tax subsidies to various employee benefit arrangements. Those who benefit most from these subsidies—due to their tax bracket—are the highest paid employees and owners. This legislation reinforces a principle of our tax system that the price of this publicly provided benefit properly should be the nondiscriminatory provision of these benefits to all workers. As the late President Kennedy once remarked, "A rising tide lifts all boats."

Mr. Speaker, it is my understanding that Chairman ROSTENKOWSKI of the Committee on Ways and Means is today announcing a public hearing on H.R. 6410, the Pension Equity Tax Act of 1982, for Tuesday, June 8, 1982.

A detailed section-by-section technical analysis of the bill follows:

EXPLANATION OF H.R. 6410, THE PENSION EQUITY TAX ACT OF 1982

SECTION 1. SHORT TITLE

SECTION 2. OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

In order to limit the extent to which individuals can use tax-favored arrangements to provide for retirement, the plan qualification rules provide overall limits on contributions and benefits under qualified pension, etc., plans.

Under a defined contribution plan (e.g., a profit-sharing plan) the qualification rules provide an overall limit on the annual additions with respect to each plan participant. Generally, the annual addition (consisting of employer contributions, certain employee contributions, and forfeitures allocated from the accounts of other participants) is limited to the lesser of (1) 25 percent of compensation for the year, or (2) $25,000 adjusted for inflation (CPI) since 1974. The limit is $45,475 for 1982.

Under a defined benefit pension plan, the annual benefit derived from employer contributions which may be provided for the life of a participant is subject to an overall limitation of the lesser of (1) 100 percent of average compensation, or (2) $75,000, adjusted for inflation (CPI) since 1974. The limit is $136,425 for 1982.

The annual benefit is the equivalent of a retirement benefit for the life of the employee, beginning at age 55 or later, and without regard to certain survivor benefits. If the retirement benefit begins before age 55, the annual benefit limitation is reduced to the actuarial equivalent of the full limit.

If a participant is covered by both a defined contribution and a defined benefit plan of the same employer, that participant's aggregate limit is equal to 140 percent of the separate limits otherwise applicable to each plan (e.g., if the defined benefit plan provided benefits equal to 90 percent of the separate defined benefit limit, the maximum amount which could be contributed to a defined contribution plan would be 50 percent of that separate limit).

Under the bill, several changes would be made to the overall limitations on contributions and benefits. First, the maximum dollar limitations would be reduced from $136,425 and $45,475 to $90,000 and $30,000. Second, those dollar amounts would no longer be subject to automatic cost-of-living increases. Third, the aggregate limit applied to a participant covered by both a defined contribution and a defined benefit plan maintained by the same employer would be reduced from 140 percent to 100 percent of the otherwise applicable separate limits. Finally, under the bill, if the retirement benefit under a defined benefit plan begins before age 65, the $90,000 limitation would be reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 65.

The bill also provides that post-retirement medical benefits provided with respect to a plan participant (including post-retirement benefits provided a spouse or dependent of an employee) are to be taken into account in determining whether plan benefits exceed the $90,000 annual limit. It is intended that, under regulations prescribed by the Secretary of the Treasury, the aggregate amount of post-retirement medical benefits payable with respect to a retiree could not exceed the amount which would be required to provide an annuity for the life of the retiree equal to the $90,000 limit less the annual retirement benefit payable to the retiree under the plan.

For existing plans, the provision would apply to years ending after December 31, 1983. For new plans, the provision would apply to years after enactment.

SECTION 3. LOANS TO PLAN PARTICIPANTS

A qualified pension, etc., plan generally is permitted to make a loan to a plan participant if certain requirements are met. Generally, the loan must bear a reasonable rate of interest, be adequately secured, provide a reasonable repayment schedule, and be made available on a basis which does not discriminate in favor of employees who are officers, shareholders, or highly compensated. However, an H.R. 10 plan is not permitted to lend to an owner-employee (a sole proprietor or a partner whose partnership interest exceeds 10 percent). Also, if a self-employed individual (whether or not an owner-employee) participating in an H.R. 10 plan borrows from the plan or uses an interest in the plan as security for a loan, the transaction is treated as a plan distribution, and the usual tax rules for distributions apply.

The bill would replace the present law loan restrictions with uniform rules applicable to all qualified pension, etc., plans, including those of corporate employers. Under the bill, if a key employee receives a loan from a plan or uses an interest in the plan as security for a loan, the amount received or pledged would be treated as a distribution for income tax purposes.

Key employees generally would include employees who are officers, those with more than a 5-percent ownership interest in the employer maintaining the plan, and those who are among the highest paid 15 percent of the employer's employees.

For purposes of the loan rules, an employee who elects to defer amounts pursuant to a qualified cash or deferred arrangement under a qualified plan would be treated as a key employee with respect to amounts attributable to the elective deferrals. Also, an employee for whom an employer purchases a tax-sheltered annuity contract would be considered a key employee with respect to the contract.

SECTION 4. INTEGRATION WITH SOCIAL SECURITY

Under the tax qualification rules, a pension, etc., plan must not discriminate in favor of employees who are officers, shareholders, or highly compensated by providing them with contributions or benefits that are a higher percentage of their pay than the contributions or benefits provided for other employees. A plan can qualify if either contributions under the plan or benefits under the plan satisfy the nondiscrimination rules.

Under present law, in determining whether pension plan benefits, as a percentage of pay, discriminate in favor of employees who are highly compensated, the portion of each employee's social security benefits considered provided by the employer may be taken into account. If those social security benefits and the employer-provided benefits under the plan, when added together, do not provide a discriminatory benefit, the benefits under the plan are considered as not discriminating in favor of highly compensated employees. Such a plan is said to be integrated with social security.

Under social security integration rules promulgated by the Internal Revenue Service, an employee's annual pension benefit may be reduced by up to 83⅓ percent of the primary insurance amount (PIA) to which the employee is entitled under social security.

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Under the integration rules for defined contribution plans (e.g., profit-sharing plans) social security benefits are taken into account by reducing contributions with respect to the portion of an employee's pay subject to the social security tax (the social security taxable wage base). The Internal Revenue Service has determined that the employer's cost of providing social security benefits is 7 percent of the taxable wage base (in 1982, $32,400). Accordingly, an integrated profit-sharing plan could provide contributions of 7 percent of 1982 pay in excess of $32,400, and no contributions with respect to the first $32,400 of pay. Alternatively, it could provide for contributions of 10 percent of pay over wage base and 3 percent of pay up to the wage base. For 1982, the employer's actual tax rate with respect to old age, survivors and disability insurance (OASDI) under social security is 5.4 percent of the first $32,400 of pay.

The bill would revise the social security integration rules to insure that an employer may reduce pension plan benefits by no more than the employee's social security benefits directly attributable to the employer-provided contributions to the social security system for the employee. The bill would permit an employee's annual pension benefit to be reduced by no more than an amount equal to the annual benefit which could be purchased with the aggregate social security (OASDI) taxes actually paid by the employer on behalf of the employee. Thus, an employee's pension benefit could not be reduced on account of social security benefits properly attributable to taxes paid by prior employers or to the "insurance" feature of social security under which benefit levels are set without regard to the sum of the actual taxes paid on behalf of the beneficiary.

Under the bill, the Secretary of the Treasury is to prescribe regulations for converting the aggregate social security taxes paid by an employer to an equivalent annual pension benefit. Of course, these rules would provide for compounding the annual employer OASDI taxes at an appropriate interest rate.

The bill also provides an alternative "safe-harbor" rule for defined benefit pension plans. Under this rule, a plan would be considered properly integrated with social security if (1) the rate of contributions or benefits for pay in excess of $30,000 but less than $60,000 was not more than twice the rate for pay below $30,000, and (2) the rate for pay in excess of $60,000 is not greater than the rate for pay less than $30,000. Thus, under the alternative safe-harbor rule, a plan could provide a simplified benefit or contribution formula which need not take into account actual social security taxes paid by the employer on behalf of individual employees.

With respect to profit-sharing and other defined contribution plans, the bill permits an employer to reduce plan contributions on behalf of an employee by no more than an amount equal to the employee's taxable wage base multiplied by the actual social security (OASDI) tax rate (5.4 percent for 1982, 1983 and 1984).

Under the bill, the new social security integration rules for profit-sharing and other defined contribution plans would apply to plan years ending after December 31, 1983. For defined benefit pension plans, the new rules would apply only with respect to employees who become plan participants after December 31, 1983.

SECTIONS 5 AND 6. SPECIAL RULES APPLICABLE TO PLANS COVERING SELF-EMPLOYED INDIVIDUALS AND CERTAIN EMPLOYEES OF PROFESSIONAL SERVICE CORPORATIONS

Under present law, a pension or profit-sharing plan which covers a self-employed individual (an H.R. 10 plan) is subject to special rules which are in addition to the Code's other tax qualification requirements. Under these special rules, annual employer contributions to a profit-sharing or other defined contribution plan on behalf of a self-employed individual are employer contributions to a qualified defined benefit which can be provided excluded from the gross income of a self-employed individual are limited to the lesser of $15,000 or 15 percent of compensation. A corresponding limit applies to the benefits which can be provided a self-employed individual under a qualified defined benefit pension plan. These limits are generally lower than the overall limits on contributions and benefits which apply with respect to all employees under qualified plans.

H.R. 10 plans which cover an owner-employee (a sole proprietor or a partner whose partnership interest exceeds 10 percent) are required to meet additional special standards. These special standards—

(1) generally require that the plan benefit all employees who have completed at least three years of service with the employer;

(2) require than an employee's rights to plan benefits are nonforfeitable at the time the contributions are made (i.e., the plan must provide full and immediate vesting);

(3) specially limit (or, in some cases, preclude) integration of the plan with social security;

(4) require that the trustee of a trust forming a part of the plan be a bank or other qualifying financial institution;

(5) limit (or in some cases preclude) voluntary nondeductible contributions to the plan by an owner-employee;

(6) generally prohibit the payment of benefits to an owner-employee before the owner-employee attains age 59½;

(7) require that the payment of plan benefits to an owner-employee begin no later than the taxable year in which the owner-employee attains age 70½; and

(8) require that benefits payable with respect to a deceased owner-employee generally be paid to the beneficiary within five years after the employee's death.

In addition, under the income tax rules, if an owner-employee receives a distribution from an H.R. 10 plan before reaching age 59½ or becoming disabled, the amount of the distribution includible in gross income is subject to an additional 10-percent income tax, and generally no contributions may be made to an H.R. 10 plan on behalf of the owner-employee for the five taxable years following the taxable year of the distribution.

The bill increases the deduction limit for employer contributions to defined contribution H.R. 10 plans from $15,000 to $30,000. The 15-percent limit on contributions is not changed. A conforming change increases permitted benefit accruals under a defined benefit H.R. 10 plan.

In addition, under the bill, certain of the special owner-employee H.R. 10 rules, including those relating to participation, vesting, and certain restrictions on contributions, benefits, and distributions would be expanded to apply to all H.R. 10 plans (i.e., to plans covering partners whose individual partnership interests do not exceed 10 percent).

Finally, the bill would supply the H.R. 10 rules to plans of professional service corporations. Any shareholder-employee of a professional service corporation would be treated as a self-employed individual, and any shareholder-employee whose ownership interest exceeds 10 percent would be treated as an owner-employee under the pension rules.

Personal service corporations subject to the H.R. 10 rules would include any corporation the principal function of which is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics, or consulting.

These provisions generally would apply to taxable years and plan years beginning after December 31, 1983. However, an employer could elect to apply the provisions beginning with the first taxable year and plan year beginning after December 31, 1982.

SECTION 7. STATUTORY FRINGE BENEFIT PLANS

Present law generally excludes from an employee's income the cost of the first $50,000 of employer-provided group-term life insurance. Additional income exclusions for employer-provided fringe benefits apply to (1) accident or health plans, (2) prepaid legal services plans, (3) van pooling plans, (4) educational assistance programs, and (5) dependent car assistance programs. Except with respect to group-term life insurance and benefits received under an accident or health plan (other than a self-insured medical reimbursement plan), the income exclusion does not apply if the fringe benefit plan discriminates in favor of employees who are officers, shareholders, or highly compensated.

Under present law, different rules prohibiting discrimination apply with respect to each type of plan. These rules generally prohibit discrimination as to eligibility to participate. Anti-discrimination rules for some of the plans also prohibit discrimination as to contributions or benefits. The antidiscrimination rules for the separate plans generally do not provide guidance as to when an employee is considered highly compensated or the extent of stock ownership required before an employee is considered a shareholder.

Under present law, if a plan is determined to discriminate in favor of employees who are officers, shareholders, or highly compensated, the otherwise applicable income exclusion generally is denied for all benefits paid under the plan, including those benefits paid to rank-and-file employees.

The bill would repeal the separate antidiscrimination rules now applicable to (1) self-insured accident or health plans, (2) prepaid legal services plans, (3) "van pooling" plans, (4) educational assistance programs, and (5) dependent care assistance programs. The bill would substitute uniform rules which would apply to all statutory fringe benefit plans.

Under the bill, if a statutory fringe benefit plan discriminates in favor of key employees, the fringe benefits provided to key employees under the plan would be allocated to them and would be included in their gross income. Benefits provided employees who are not key employees would remain eligible for the present-law income exclusions.

Under the bill, key employees would include employees who are (1) officers, (2) more than 5-percent owners, or (3) among the highest paid 15 percent of all employees of the employer. A discriminatory statutory fringe benefit plan would be one which discriminates in favor of key employees as to eligibility to participate, or as to the type and amounts of benefits available under the plan. The exent to which key employees, relative to other employees, actually utilize

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plan benefits would not be taken into account under a plan otherwise determined to be nondiscriminatory.

Under the bill, a statutory fringe benefit plan would not be considered to discriminate in favor of key employees as to eligibility to participate if (1) the plan benefits at least 70 percent of all employees, (2) at least 85 percent of all participating employees are not key employees, or (3) the plan benefits employees who qualify under a classification set up by the employer and found by the Secretary of the Treasury not be discriminate in favor of key employees. In applying these and other tests under the bill, employees of related employers would be treated as if employed by a single employer. For purposes of these rules, however, the following employees could be excluded from consideration: (1) those who have not completed 3 years of service with the employer, (2) part-time and seasonal employees, and (3) nonresident aliens who receive no U.S. income from the employer. In addition, the bill provides that employees not covered by the plan but covered by a collective bargaining agreement need not be taken into account if the benefits provided under the plan were the subject of good faith bargaining between the employer and the employee representatives.

The bill provides that a statutory fringe benefit plan would be discriminatory with respect to the benefits available under the plan unless all benefits available to participating key employees are also available to all other participating employees. Under a special rule, however, a group-term life insurance plan would not be considered discriminatory merely because the amount of life insurance provided employees bear a uniform relationship to compensation.

The provisions of the bill relating to statutory fringe benefit plan would apply to plan years ending after December 31, 1983.

SECTION 8. ESTATE TAX EXCLUSION FOR RETIREMENT SAVINGS

Under present law, benefits payable to a beneficiary of a deceased employee under a qualified pension, etc., plan, certain Federal retirement plans, or a tax-sheltered annuity are generally excluded from the decedent's gross estate to the extent attributable to employer contributions or to deductible employee contributions. Also, amounts payable to a decedent's beneficiary under an IRA generally can also be excluded from the decedent's gross estate. No dollar limit applies to these exclusions.

The bill would impose an aggregate $500,000 limit on the estate tax exclusion otherwise applicable to amounts payable under a qualified pension, etc., plan, tax-sheltered annuity, or IRA.

The provision would apply to estates of decedents dying after December 31, 1982.●

REPORT ON FEDERAL ADVISORY COMMITTEES

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Oklahoma (Mr. ENGLISH) is recognized for 5 minutes.

● Mr. ENGLISH. Mr. Speaker, the 10th Annual Report on Federal Advisory Committees, covering calendar year 1981, was sent to the Congress on April 19, pursuant to a requirement of the Federal Advisory Committee Act (Public Law 92-463).

The 141-page report, prepared by the General Services Administration, includes a brief introductory narrative; alphabetical and agency lists of committees; charts showing the number of meetings and cost of each agencies' advisory groups; a roster of agency officials responsible for advisory committee management; and an appendix which contains the text of the act and relevant executive branch documents.

Here are some of the highlights of and a bit of commentary on the report:

First. As of December 31, 1981, there were 853 advisory committees. The 1980 yearend total was 865. During the year 114 committees were terminated. However, 34 of these committees were reestablished by year's end and 68 entirely new advisory groups were also formed. Thus, there was a net reduction of 12 committees.

It is a distinct possibility that agency officials may have held back until after the first of the year, in order to make the 1981 yearend totals look good. In the first 3 months of this year, no committees were terminated and 29 new committees have been chartered, with 18 of those coming in January.

Second. The report shows a significant decrease in the costs to operate and support advisory committees in 1981. Actual costs are reported to be down some $7.3 million from the 1980 level, to $80.1 million for 1981. As I will discuss in a moment, there may be a rather simple explanation for what appears to be an 8.3-percent decrease in operation costs: a decrease which has little, if anything, to do with the claim of improved management of the committee process. But first, let me tell you about the projection that costs will not rise in 1982—that they will remain at the 1981 level.

Just a cursory examination of the summary tables included in the President's report shows that the $80.1 million estimate for 1982 operating costs pertains to continuing the 853 committees in existence at yearend 1981. During 1981, however, these same 853 committees cost only $70.7 million to operate. So, what we really have is a projected increase of 14 percent in 1982 operating costs, not any freeze in costs-and that is before the cost of any new committees is factored in. And, as I mentioned previously, 29 new committees have been created in just the first 3 months of this year.

Third. Overall, advisory committees met 3,459 times during 1981. Of those meetings 2,022 (58 percent) were open; 746 (22 percent) were wholly closed to the public; and 691 (20 percent) were partially closed. The 1981 figures for openness show a slight decrease from the 62 percent achieved last year. As in past years, the U.S. Commission on Civil Rights had the highest percentage of open meetings—all of its 180 meetings were open. And, once again, the National Endowment for the Humanities is at the other extreme, having opened just 11 of its 155 meetings to the public.

Mr. Speaker, earlier I mentioned that there might be a simple explanation for the 8.3-percent savings in operating costs claimed in the President's report. What I was referring to was that the 3,459 advisory committee meetings held last year are some 600 fewer than were held in 1980. Since the bulk of advisory committee operating expenses involve staff support, travel costs, and per diem expenses for advisory committee members, it appears that a 15-percent decrease in the number of meetings held last year more than accounts for the claimed 8.3 percent savings in operating costs.

One might even be moved to ask why costs were not down even more in 1981. Actually, if you look at this on a cost per meeting basis, costs were up in 1981. What may be even more important though, is that agencies seem to have chosen the easy way out in achieving sought after savings; they simply cut the number of meetings held last year.

According to the "findings and purposes" section of the act, advisory groups "are frequently a useful and beneficial means of furnishing expert advice, ideas, and diverse opinions to the Federal Government." It then states that "advisory committees should be terminated when they are no longer carrying out the purposes for which they were established," that is, when they are no longer giving advice. Six hundred fewer meetings implies that many committees were called on to give less or no advice. Perhaps, some were no longer carrying out the purposes for which they were established and, therefore, should have been terminated. The result would have been real, rather than contrived savings.

Fourth. While the number of committees was down slightly at year's end, the number of individuals serving on committees increased last year by some 750 to 22,198. This change is probably not significant. However, there are some developments involving service on advisory committees that are, to say the very least, both troubling and significant.

There have been rumblings for some months that administration officials were going to great lengths to insure that those who are appointed to advisory groups have the correct perspective. I do not know what to make of this until earlier this month when a short piece appeared in the May issue of Science indicating that Secretay of Agriculture Block has enlisted the aid of the FBI to screen potential advisory committee members "for security risks and political compatibility." Then, on Friday, May 7, the Washington Post carried a story about Education and Justice Department advisory groups entitled, "Wholesale Firings Hit Advisory Councils." According to the article, the senior minority member of the House Education and Labor Committee was prompted to write the new head of the Vocational Education Council urging him to "preserve the

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COORDINATION OF EMPLOYER-SPONSORED, TAX QUALIFIED PRIVATE RETIREMENT PROGRAMS WITH SOCIAL SECURITY

The principal objective of our total national retirement income system, including both Social Security and public or private employer-sponsored pension programs, is to insure that every retired person in America enjoys an adequate standard of living.

The Social Security System properly weights benefits, expressed as a percentage of working wages, toward lower income persons. Simply stated, lower income persons require a higher proportion of working income in retirement in order to maintain an adequate standard of living.

TABLE I-3
Age 65 Social Security Pretax Replacement Rates—1979

	Single Worker	Worker with Dependent Spouse
Maximum Covered Wage Earner	25%	38%
Average Covered Wage Earner	44	65
Full-Time Minimum Wage Earner	57	85

Source: U.S. Department of Health and Human Services, Advisory Council on Social Security, *Social Security Financing and Benefits* (1979), p. 59.

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*The Social Security minimum benefit has been eliminated for all persons retiring after January 1, 1982.

Employer provided pensions in the private sector receive certain favorable tax treatment. Basically, employer contributions to fund pension benefits are deductible as an ordinary business expense and are not taxable to the employee until such time as a benefit or distribution from the pension fund is actually made. This favorable tax treatment is granted by Congress on the condition that private pension plans benefit all employees; not just highly paid persons. The law also recognizes that employer contributions to Social Security, which are a level percentage of covered wages, are used to provide substantially greater benefits for lower-income persons than for middle-income persons. In recognizing that fact, the law allows private plan sponsors to provide pension benefits which make up a portion of the disparity in treatment between lower and middle income persons in the pension benefits they provide.

Unfortunately, the rules which specify the mechanics of coordinating private plans with Social Security were constructed in 1971. Since those rules were adopted, three major amendments have been made to the Social Security law. As a result, the coordination rules are flawed in relation to the current Social Security law. In simplified terms, the two principal flaws:

1) allow the private plan sponsor to take disproportionate account of Social Security benefits in providing private plan benefits to short-service employees; and

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2) consider the provision of ancillary benefits under Social Security for death, disability and health care in the coordination of pension benefits.

It should be noted that the vast majority (over 80%) of private plans do not take disproportionate account of Social Security. However, a few do, which circumvents the anti-discrimination condition on which Congress has granted the favorable tax treatment mentioned previously.

In recognition of this problem, several legislative proposals have been advanced in recent years which were intended to correct it. Unfortunately, these proposals have approached the problem from a mechanical standpoint, without adequate consideration of the underlying objective for coordination of private plans and Social Security; to provide adequate retirement income for all workers. The most recent of these proposals is contained in a bill (HR 6410) sponsored by Mr. Charles Rangel (D.,N.Y.) and introduced in the House of Representatives on May 19. Although the coordination rule contained in the bill is intended to correct the problems which exist in the current rules, its actual effect would be to make it virtually impossible to rationally coordinate private pension plans with Social Security.

The proper coordination of Social Security and private retirement systems is a complex issue for which an overly-simplistic approach is bound to fail. If a rational rule of law is to be developed, it is essential that qualified experts in business and the actuarial and legal professions work to produce such a rule. Unless the private retirement system and its professional advisors take the initiative to design a new set of rules which correct the flaws of the present ones, we will continue to be faced with proposals such as that contained in Mr. Rangel's bill. More important, if we do not take such initiative, we face the clear danger that an ill-conceived rule will become law and do irreparable harm to our national retirement system.

Following is a statement of policy for the coordination of private pension benefits and contributions with the benefits and contributions of Social Security. This statement is offered only as a starting point and should be examined thoroughly by knowledgeable professionals in the benefit field.

In coordinating private defined benefit pension plans with Social Security, each employer should be able to take into consideration the portion of employer financed ultimate Social Security benefits attributable to service with that employer; or, if greater, a portion of the ultimate Social Security benefit which corresponds to the benefit provided under the plan. In coordinating private defined contribution plans with Social Security, each employer should be able to take into account employer contributions to the Old Age, Survivor and Disability Insurance portion of the Social Security System.

In order to design a rule of law which relates to the above stated policy, it is necessary to carefully consider the total retirement income objective. Although there may be differences of opinion regarding a proper measurement of adequate retirement income, the President's Commission of Pension Policy recommended the following:

> "... the replacement of pre-retirement disposable income from all sources is a desirable goal".

The following tables, taken from the final report of the Commission, illustrate that objective in more quantitative terms;

See following pages.

After considering the statement of policy and objectives set forth above, we would offer the following proposed rules for integrating private pension plans with Social Security.

Again, we must emphasize that these are intended only as a starting point. They are being distributed to leaders in the private pension community in the hope that they will carefully examine them in order to refine and improve them.

DEFINED BENEFIT PENSION PLANS INTEGRATED UNDER AN "OFFSET" FORMULA.

The portion of the ultimate Primary Insurance Amount (P.I.A.) under Social Security which may be used to reduce the basic formula benefit provided for under a private defined benefit pension plan is limited to the greater of:

(a) seventy-five percent (75%) of the P.I.A. multiplied by a factor; the numerator of which is the total number of years of employment with the sponsoring employer and the denominator of which is 35; and

(b) one hundred percent (100%) of the P.I.A. multiplied by a factor; the numerator of which is the accrued monthly normal retirement benefit produced by the plan's basic formula, prior to the application of any offset, and the denominator of which is the participant's considered monthly compensation.

In determining the Primary Insurance Amount applicable to an individual participant under (a) or (b) above, in order to compute a benefit due at any time prior to age 65, both the particpant's compensation and the taxable wage base under Social Security shall be assumed to remain constant from the date of determination until the year in which the participant would attain age 65.

No adjustments to the factors computed under (a) or (b) above shall be required as a result of ancillary benefits provided by the plan in the event of the death or total disability of the participant.

DEFINED BENEFIT PENSION PLANS INTEGRATED UNDER "EXCESS" OR "STEP-RATE" FORMULAS.

The benefit formula percentage applied to considered compensation in excess of the Social Security Average Monthly Wage Base applicable to any individual participant is limited to the greater of:

(a) one and two-thirds percent (1 2/3%) multiplied by the number of years of employment with the sponsoring employer, up to a maximum of fifteen years; and

(b) two times the benefit formula percentage applied to considered compensation at or below the Social Security Average Monthly Wage Base applicable to such participant.

In determining the Social Security Average Monthly Wage Base applicable to an individual participant under (a) or (b) above, in order to compute a benefit due at any time prior to age 65, the taxable wage base in effect for the year of such

determination shall be assumed to remain in effect from the year of such determination until the year in which the participant would attain age 65.
No adjustments to the benefit formula percentages under (a) or (b) above shall be required as a result of ancillary benefits provided by the plan in the event of the death or total disability of the participant.

In the case of a participant who is also covered under a defined contribution pension plan to which the employer contributes on behalf of such participant and under which plan the employer's contributions are not integrated with contributions to Social Security, the percentage (1 2/3) in (a) above shall be increased to two percent (2%).

DEFINED CONTRIBUTION PLANS INTEGRATED WITH SOCIAL SECURITY

The percentage of employer contribution on behalf of any individual participant in any year applied to considered compensation in excess of the taxable wage base in effect for that year is limited to the sum of the rate of the employer contribution for Old Age Survivor and Disability Insurance benefits under Social Security and the percentage of employer contribution applied to considered compensation equal to or less than the taxable wage base in effect for such year.

No adjustments to the above percentages shall be required as a result of ancillary benefits provided by the plan in the event of the death or total disability of the participant.

The above rules are structured in recognition of:

1. the anti-discrimiation provisions of the Internal Revenue Code;
2. the statement of policy regarding cordination of private plans and Social Security;
3. the expressed Congressional objective of encouraging growth and expansion of the private pension system;
4. the objective of simplifying the integration rules to the extent possible; and
5. the retirement income adequacy goals set forth by the President's Commission on Pension Policy.

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Mr. RANGEL. Mr. Chairman, may I pose some questions on the slides that were shown? I understand that your charts compare a plan that is fully integrated under the bill with a plan that is not fully integrated as it could be under present law. If you had used it differently, used the same type of plans, you would not come up with the same results.

Mr. O'FARRELL. I am not sure I understand.

Mr. RANGEL. Does the plan that you use in the chart compare a plan fully integrated with a plan not fully integrated, which it could be under the bill? By using the formula contained in the bill like that of present law it defines the maximum acceptable integration levels, but they do not require any plan to use the full offset? In other words, you have used the worst possible situation in the bill with an analogy that you have under present law. You did not use the same degree of integration with your charts that you could have used.

Mr. O'FARRELL. Sir, I used a comparable method of integration. Your bill automatically prorates the integration over service. This is a plan which prorates the integration over service.

Mr. Rangel, this is not an example of a plan that illustrates the worst case of abuse. There are plans—you can design a plan, and I think we all know that it is done, that in fact produces a substantial benefit for highly paid persons and nothing for short-service employees.

Mr. RANGEL. Anyone could select a different plan and come up with different results depending on how much integration is used in their chart.

Mr. O'FARRELL. You could certainly draw different comparisons. I think it is important to recognize, sir, that the plans that you are targeting when we look at the data base on single-employer private plans represent less than 5 percent of all the plans that exist, yet the rules in the bill could very easily have the impact that I am talking about. I believe they would. We are as incensed by the kind of abuse that you are targeting as you are, but we are afraid that the way you are going about it in the bill in its specifics, not in its intent, just will not work. I and several people that I work with have not done anything else since you introduced the bill other than go into the data base and go after this problem, and we just think it needs a much closer, harder look than it appears has been taken thus far.

Mr. RANGEL. Thank you.

Mr. Kubiczky.

STATEMENT OF STEPHEN KUBICZKY, CHAIRMAN, EMPLOYEE BENEFITS SECTION, ILLINOIS STATE BAR ASSOCIATION

Mr. KUBICZKY. I am Steve Kubiczky, a partner in the law firm of Altheimer & Gray, and chairman of the Illinois State Bar Association employee benefits section. Today I am speaking on behalf of the association and its more than 24,000 members. On behalf of the association, thank you for allowing us to present our comments.

In presenting our comments, we speak as attorneys who work closely with the private pension system and, together with you, are concerned with its continued well-being.

It is our position that to apply to the private pension system the concepts set forth in sections 2, lower contribution and benefit limits for tax-subsidized annuities, etc.; 3, loans to key employees treated as distributions; 5(b), extension of certain rules which apply to plans covering any owner-employee to plans covering any self-employed individual; 6, extension of rules applicable to plans for self-employed individuals to plans of personal service corporations; and 8, limitation on estate tax exclusions under section 2039, of H.R. 6410, "The Pension Equity Tax Act of 1982," would be great error.

Further, we believe that until the problems of the social security system have been addressed and the ultimate structure of the system settled, any significant change in the social security integration rules applicable to qualified plans is premature and counterproductive.

We believe that, with respect to welfare benefits, the current tax law does not contain a loophole or permit abuses, so that the measures set forth in section 7, key employees required to include in income benefits provided under certain discriminatory fringe benefit plans of H.R. 6410 are unwarranted and unnecessary.

Finally, we have supported and continue to support the goal of parity between the benefits available to self-employed and employed. However, rather than achieve parity, for many Americans, H.R. 6410 would likely result in elimination, or at least reduction, of retirement benefits from the private system. Therefore, notwithstanding a purported increase in the maximum limits applicable to H.R. 10 plans, we oppose H.R. 6410.

Congress may perceive elimination of cost-of-living increases and reduction in the current amount of maximum qualified retirement plan benefits as one simple method of increasing current revenue and of guaranteeing future increases without further legislation as inflation consumes the real worth of private retirement benefits. We suspect that a great many measures set forth in H.R. 6410 are intended to raise revenue. However, before it aggressively pursues the private pension system for that purpose, Congress must consider another impact.

A reduction in maximum plan limits will certainly reduce retirement benefits for the most highly compensated participants. It will just as certainly reduce retirement benefits for all other participants, unless with H.R. 6410 Congress is feeling the waters for a mandatory private pension system. It is a rare employer which will rush to sponsor a plan in which accrual rates for the lowest compensated participants exceed those for the highest compensated.

As qualified plans become less attractive, the burden on the social security system increases, and those employers desiring to provide for employees who fall in the middle-income level rely more on nonqualified deferred compensation arrangements. Many ostensibly middle-class Americans may watch unfunded benefits not guaranteed by the Pension Benefit Guaranty Corporation disappear in the morass of another Studebaker. Measures such as those contained in H.R. 6410, which make qualified plans less attractive, may increase current revenues and reduce the financial burdens of the PBGC, which are very severe at this point, but will not go far to provide a secure retirement for Americans. The qualified plan, cornerstone of the private pension system, should be strengthened, not weakened, and the American tax system should vigorously encourage, not discourage, advance funded retirement benefits. To that end, we commend to you at least one comment from "Coming of Age Toward a National Retirement Income Policy," the report of the President's Commission on Pension Policy:

> The Commission feels that our Nation's retirement income programs are dangerously dependent on pay-as-you-go systems, such as social security, supplemental security income, and inkind benefit programs. Large tax-supported programs have created an imbalance in the overall system which has serious policy implications for the future.
>
> In the long run, the Commission's recommendations would lead to a reduction in expenditures by the social security system and a substantial increase in benefit payments from employee pension plans.

We also note with some trepidation that revenue increases resulting from changes to the private pension system will be spent in part to fund cost-of-living increases which continue in the Government pension system.

We believe that limiting to $500,000 the estate tax exclusion applicable to qualified plan benefits is undesirable. Benefits with a present value at retirement in excess of $500,000 are not limited to the highly compensated and, with recent history as guidance, will become more common, note the projections we have recently seen with respect to individual retirement accounts. Is Congress to again reverse its position on the small to moderate estate? Furthermore, many persons have already taken irrevocable actions based on a fairly longstanding estate tax rule.

Many plans permit only annuity payments and, consistent with the goal of providing a stream of income for support during retirement, many authorities suggest that annuities are the preferred form of retirement benefit. However, H.R. 6410 would encourage and perhaps necessitate lump-sum distributions of death benefits as a source of funds to pay death taxes which are very severe at this point.

We believe that any perceived abuses of participant loans should be addressed by measures better designed than those set forth in H.R. 6410. The bill would result in the elimination of participant loans from most plans and ignores the socially desirable reasons for permitting and even encouraging certain loans. At the same time H.R. 6410 is being considered in other areas, the use of funds from retirement plans is being advocated as a method of stimulating housing construction and permitting families otherwise unable to secure financing to achieve the traditional American goal of homeownership.

Mr. RANGEL. Mr. Kubiczky, could you summarize the rest of your testimony?

Mr. KUBICZKY. I will summarize the conclusions.

One, we oppose strongly the elimination of cost-of-living increases or any reduction in current maximum benefits of qualified plans.

Two, we strongly oppose the proposed modification in the estate tax treatment of qualified plan benefits.

Three, we strongly oppose the extension of owner-employee qualified plan rules to all H.R. 10 plans and H.R. 10 qualified plan rules to service corporations.

Four, we suggest maintenance of existing integration rules until social security system problems are settled.

Five, we suggest that the current tax law applicable to welfare benefits is adequate.

Six, we suggest that any other perceived abuses which H.R. 6410 is meant to address can best be eliminated by measures different from those set forth in the bill.

Seven, we strongly support parity for self-employed but object to characterizing H.R. 6410 provisions as parity.

For those reasons, even though the increases for H.R. 10 plans would be applicable, we strongly oppose it.

[The prepared statement follows:]

STATEMENT OF THE ILLINOIS STATE BAR ASSOCIATION BY STEPHEN KUBICZKY, CHICAGO, CHAIRMAN OF THE ILLINOIS STATE BAR ASSOCIATION EMPLOYEE BENEFITS SECTION

My name is Stephen Kubiczky. I am a partner in the Chicago law firm, Altheimer & Gray, and Chairman of the Illinois State Bar Association Employee Benefits Section. Today, I am speaking not personally but on behalf of the Association and its more than 24,000 members. On behalf of the Association, thank you for the opportunity to present our comments. Time is limited, and many groups must appear. Therefore, our comments will be brief.

In presenting our comments, we speak as attorneys who work closely with the private pension system and together with you are concerned with its continued wellbeing. It is our position that to apply to the private pension system the concepts set forth in Sections 2, Lower Contribution And Benefit Limits For Tax-Subsidized Annuities, Etc., 3, Loans To Key Employees Treated As Distributions, 5(b), Extension Of Certain Rules Which Apply To Plans Covering Any Owner-Employee To Plans Covering Any Self-Employed Individual, 6, Extension Of Rules Applicable To Plans For Self-Employed Individuals To Plans Of Personal Service Corporations, and 8, Limitation On Estate Tax Exclusions Under Section 2039, of HR 6410, "The Pension Equity Tax Act of 1982", would be great error. Further, we believe that until the problems of the social security system have been addressed and the ultimate structure of the system settled, any significant change in the social security integration rules applicable to qualified plans is premature and counterproductive. We believe that with respect to welfare benefits, the current tax law does not contain a "loophole" or permit abuses so that the measures set forth in Section 7, Key Employees Required To Include In Income Benefits Provided Under Certain Discriminatory Fringe Benefit Plans, of HR 6410 are unwarranted and unnecessary. Finally, we have supported and continue to support the goal of parity between the benefits available to self-employed and employed. However, rather than achieve parity, for many Americans, HR 6410 would likely result in elimination or at least reduction of retirement benefits from the private system. Therefore, notwithstanding a purported increase in the maximum limits applicable to HR 10 plans we oppose HR 6410.

I

Congress may perceive elimination of cost of living increases and reduction in the current amount of maximum qualified retirement plan benefits as one simple method of increasing current revenue and of guarantying future increases without further legislation as inflation consumes the real worth of private retirement benefits. We suspect that a great many measures set forth in HR 6410 are intended to raise revenue. However, before it aggressively pursues the private pension system for that purpose, Congress must consider another impact. A reduction in maximum plan limits will certainly reduce retirement benefits for the most highly compensated participants. It will just as certainly reduce retirement benefits for all other participants, unless with HR 6410 Congress is feeling the waters for a mandatory private pension system, it is a rare employer which will rush to sponsor a plan in which accrual rates for the lowest compensated participants exceed those for the highest compensated. As qualified plans become less attractive, the burden on the social security system increases and those employers desiring to provide for employees rely more on non-qualified deferred compensation arrangements. Many ostensibly middle-class Americans may watch unfunded benefits not guaranteed by the Pension Benefit Guaranty Corporation disappear in the morass of another Studebaker. Measures such as those contained in HR 6410 which make qualified plans less attractive may increase current revenues and reduce tha financial burdens of the PBGC, but will not go far to provide a secure retirement for Americans. The qualified plan, cornerstone of the private pension system, should be strengthened, not weakened, and the American tax system should vigorously encourage, not discourage advance funded retirement benefits. We commend to you at least one comment from "Coming of Age Toward a National Retirement Income Policy", the report of the President's Commission on Pension Policy:

"The Commission feels that our nation's retirement income programs are dangerously dependent on pay-as-you-go systems, such as social security, supplemental security income, and in-kind benefit programs. Large tax supported programs have created an imbalance in the overall system which has serious policy implications for the future. . . .

"In the long run, the Commission's recommendations would lead to a reduction in expenditures by the social security system and a substantial increase in benefit payments from employee pension plans."

We also note with some trepidation that revenue increases resulting from changes to the private pension system will be spent in part to fund cost of living increases which continue in the government pension system.

II

We believe that limiting to $500,000 the estate tax exclusion applicable to qualified plan benefits is undesirable. Benefits with a present value at retirement in excess of $500,000 are not limited to the highly compensated and, with recent history as guidance, will become more common, note the projections we have recently seen with respect to Individual Retirement Accounts. Is Congress to again reverse course on the small to moderate estate? Furthermore, many persons have already taken irrevocable actions based on a fairly long standing estate tax rule.

Many plans permit only annuity payments and, consistent with the goal of providing a stream of income for support during retirement, many authorities suggest that annuities are the preferred form of retirement benefit. However, Section 8 of HR 6410 would encourage and perhaps necessitate lump sum distributions of death benefits as a source of funds to pay death taxes.

III

We believe that any perceived abuses of participant loans should be addressed by measures better designed than those set forth in HR 6410. Section 3 of HR 6410 would result in the elimination of participant loans from most plans and ignores the socially desirable reasons for permitting and even encouraging certain loans. At the same time HR 6410 is being considered, the use of funds from retirement plans is being advocated as a method of stimulating housing construction and permitting families otherwise unable to secure financing to achieve the traditional American goal of home ownership. In many instances, participants can rely on participant loans to pay large unexpected medical bills or, during this time of rising costs and diminishing assistance, to finance the education of children. In short, participant loans can help meet financial hardships without resorting to public assistance.

The ability to borrow can also encourage plan participation. Without it, young employees more concerned with current living than with retirement, caught in a credit squeeze, must frequently opt for increased current compensation over a more secure future.

IV

We strongly oppose an extension of the "owner-employee" qualified plan rules to all HR 10 plans and the extension of HR 10 qualified plan rules to plans maintained by so-called "personal" service corporations. There is simply no logical or philosophical basis to necessitate or justify a special category of rules for self-employed persons or for persons whose work involves a particular skill. Pursuant to HR 6410, the engineering company which designs the maintenance system of a building will be treated differently than the construction company which installs it, even though both companies have the same employee census and compensation levels, the same revenues, and are otherwise similar including type of work. Further, shaving the categories razor thin, the construction company can be subject to either of two sets of rules merely because of the form in which it does business. The tax laws need less, not more complexity.

V

We believe that any change in existing social security integration rules is premature. Current problems of the social security system have been well publicized. Americans wonder what the system will be even in the very near term. The National Commission on Social Security Reform is still pondering the situation. Tinkering now with integration may precipitate unknowable results. The appropriate order of affairs is to settle the social security system, then develop a fair and equitable method of integrating it with the private pension system.

VI

We believe that no abuses Congress may perceive of employee welfare benefits should be addressed by measures as drastic as those of HR 6410. Although their cost is great, welfare benefits simply do not constitute a large enough portion of the overall benefit program of most small and medium employers to lead to abuses. Most welfare benefits are provided through insurance, the economic factors of which are self-regulating. The Internal Revenue Service has issued a number of rulings which adequately define and limit the use of insurance. Under the current rules, a small employer with the assistance of a competent insurance agent can still cope with a simple welfare program. Injecting one more level of complexity is inadvisable because the benefits available are simply not large enough to justify the frustration and expense to employers.

VII

Finally, we strongly support the concept of parity in the benefits available to self-employed and employed persons. We object to characterizing the provisions of HR 6410 as parity measures. Not only does HR 6410 fail to achieve parity, it creates an even greater and unwarranted discrimination against providers of specific services.

In conclusion, we reiterate our positions:

1. We strongly impose elimination of cost of living increases or any reduction in the maximum benefits of qualified plans.
2. We strongly oppose the proposed modification in the estate tax treatment of qualified plan benefits.
3. We strongly oppose the extension of "owner-employee" qualified plan rules to all HR 10 plans and HR 10 qualified plan rules to service corporations.
4. We suggest maintenance of existing integration rules until social security system problems are settled.
5. We suggest that the current tax law applicable to welfare benefits is adequate.
6. We suggest that any other perceived abuses which HR 6410 is meant to address can best be eliminated by measures different from those set forth in the Bill
7. We strongly support parity for self employed but object to characterizing HR 6410 provisions as parity.

We feel HR 6410, an ill-advised attempt to generate tax revenue from the private retirement system, is likely to threaten the secure senior years of a great many Americans while keeping lawyers busy for some time with plan sponsors grown tired of the ever changing retirement policy of this country.

Mr. RANGEL. Mr. Dearnley.

STATEMENT OF IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. DEARNLEY. Mr. Chairman and members of the committee, my name is Irvine H. Dearnley, and I am a vice president of Citibank, N.A. I am before you today representing the National Association of Manufacturers.

As a large number of our members maintain one or more employee benefit plans, the NAM is very interested in any congressional proposal which would affect these plans, and welcomes this opportunity to comment on H.R. 6410, the Pension Equity Tax Act of 1982.

The field of employee benefits, particularly that of retirement benefits, is extremely complex. The current state of affairs in this field is codified in a major document referred to by both experts and nonexperts as ERISA. ERISA was the end product of a legislative process that lasted approximately 10 years.

The introduction of H.R. 6410 signals to the millions of participants and beneficiaries of the thousands of pension and welfare plans in the United States that some Members of Congress feel further changes must be made in the rules that govern the operation of the programs. However, the changes called for by H.R. 6410 are not just additional fine tuning, but instead represent major changes in Federal law—in some cases outright reversal of long-established policy and philosophy governing the design of most of the employee benefit plans.

What is most troublesome to the NAM and many others concerned with employee benefits is the apparent haste with which H.R. 6410 was created and the seeming lack of recognition of its impact on so many persons covered by our private pension plans.

It is of concern to the NAM that this bill was not referred to the Committee on Education and Labor for its consideration. We feel certain that if viewed within the perspective of what is appropriate national employee benefit policy—as opposed to revenue considerations—most of the provisions of H.R. 6410 would not survive.

I want to emphasize that we have not had time to fully analyze the impact of all of the provisions of H.R. 6410. However, we have concluded that the bill would:

Reduce the incentive for employees to provide for their own retirement through contributions to corporate savings plans;

Add to the current problems of the social security system as a result of weakening the private pension system;

Discriminate unfairly against the participants and beneficiaries of private plans in favor of those covered by congressional, civil service, and other governmental plans;

Adversely affect the creation of long-term investment capital;

Impose a complex and punitive system of procedures for coordinating private pensions and social security benefits; and

Add to the already burdensome reporting and filing requirements currently experienced by American business.

While time will not permit a section-by-section review of H.R. 6410, it is appropriate to point to several examples of how this bill has failed to recognize the adverse policy implications of its provisions. Some of the other testimony, no doubt, will emphasize points not covered by us.

First, elimination of the 1.4 rule.

Prior to ERISA, there were no real restrictions on the benefits which could be provided through two or more plans. In effect, the pre-ERISA rule was 2.0. The decision to allow employers to provide benefits at the current 1.4 level recognized several important factors. First, employers that went beyond the 1.0 level did so because they sponsored defined contribution plans—usually involving employee contributions. These plans often serve purposes beyond the mere accumulation of funds for retirement. However, funds intended for purposes other than retirement are still fully charged against the 1.4 limits.

A second reason for the 1.4 rules lies in the fact that employee contributions are so frequently associated with defined contribution plans. Recent changes in the Internal Revenue Code and new regulations have caused a very encouraging new interest in plans which provide for employee deferrals of income for purposes of long-term investment. The elimination of the current 1.4 rule could deal a severe blow to those new efforts aimed at beefing up the two legs of the retirement stool other than the social security system. Employee contributions for their own retirement benefit might reduce their employer-provided benefits—on a dollar-for-dollar basis—under a 1.0 system, making such programs very unattractive to employees.

This would also reverse the direction of public policy in another area with respect to these plans. For example, the provision to treat loans to all employees in section 401(k) cash or deferred plans as taxable distributions might cripple those plans—many of which are already in place or about to become effective. Thus, this legislation would discourage defined contribution plans at a time when sound public policy demands that they be encouraged. Contributory plans form a vitally important component of our retirement system. Individuals should be encouraged to save for their own retirement, especially in view of the uncertainties surrounding the future of the social security system.

In addition, defined contribution plans almost invariably contain features that are favorable to participants, such as early vesting and portability of benefits. They are currently among the best understood and most appreciated of retirement programs. This bill would unfortunately weaken the self-help concept, making these programs less effective.

The changes proposed in the social security integration rules are another example of the lack of full policy consideration with which H.R. 6410 appears to have been developed. Consistent with the bill's apparent intent, the integration rules would reduce the level of allowable social security offset drastically for employees who terminate employment at what is typically called retirement age. However, for almost all employees currently under age 45 or 50, the bill's rules could increase substantially the allowable integration and the amount of their pension that could be offset by their employer. The impact of the latter could permit defined benefit plans to reduce or eliminate the level of vested benefits for the younger members of the work force. We doubt that this is a result intended by the bill's authors.

Sound public policy in this area for defined benefit plans should focus on the coordination of benefits provided by social security and private pension plans, not on contributions or who pays taxes. Retirees live on benefits paid by private plans and social security, not on the contributions or taxes paid into those programs. The taxes paid today for OASDI were designed only to match revenues attributable to current workers with payments to current beneficiaries. The taxes for current workers bear no relationship to the cost of benefits which they will ultimately receive.

[The prepared statement follows:]

STATEMENT OF IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A. ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Chairman and members of the Committee, my name is Irvine H. Dearnley, and I am a Vice President of Citibank, N.A. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every state. Our members employ 85 percent of the workers in manufacturing employment and produce over 80 percent of the Nation's manufactured goods.

As a large number of our members maintain one or more employee benefit plans, the NAM is very interested in any congressional proposal which would affect these plans and welcomes this opportunity to comment on H.R. 6410, the Pension Equity Tax Act of 1982.

EMPLOYEE BENEFITS—A COMPLEX UNIVERSE

The field of employee benefits, particularly that of retirement benefits, is extremely complex. The current state of affairs in this field is codified in a major document referred to by both experts and non-experts as ERISA. ERISA was the end product of a legislative process that lasted approximately 10 years, commencing with the President's Cabinet Committee Report of 1965. It was finally signed into Law by President Ford on Labor Day of 1974.

Since that time, continual judicial and regulatory fine-tuning of this Nation's statutory employee benefits policy has taken place. The Congress has also made changes in this area as well—the most recent and significant being the multiemployer amendments to ERISA in 1980 and the capital formation incentives which were made part of the 1981 Economic Recovery Tax Act. Of this last set of changes, some have yet to become effective.

The introduction of H.R. 6410 signals to the millions of participants and beneficiaries of the thousands of pension and welfare plans in the United States that some members of Congress feel further changes must be made in the rules that govern the operation of the programs designed to protect this country's widowed, aged, and infirm citizens. However, the changes called for by H.R. 6410 are not just additional fine-tuning, but instead represent major changes to federal law—in some cases outright reversal of long established policy and philosophy governing the design of most of the employee benefit plans of American businesses.

What is most troublesome to the NAM and many others concerned with employee benefits is the apparent haste with which H.R. 6410 was created and the seemingly lack of recognition of its impact on so many persons covered by our private pension plans. Of a similar concern is that this bill is regarded as a revenue measure, part of the current budget proposals under consideration. We appreciate the problems that face the Congress in attempting to deal with large projected budget deficits, but do not feel there has been sufficient attention given by the drafters of H.R. 6410 to the long-range impact of the major policy changes called for by the bill.

As the title of H.R. 6410 implies, an additional stated purpose is to establish "equity" in the pension area. Far from accomplishing that purpose, we believe this bill would have a far-reaching and negative impact on the private employee benefit system. It would significantly weaken the private retirement system and reduce long-term savings. It is of concern to the NAM that this bill was not referred to the Committee on Education and Labor for its consideration. We feel certain that if viewed within the perspective of what is appropriate national employee benefit policy (as opposed to revenue considerations), most of the provisions of H.R. 6410 would not survive.

PROVISIONS OF H.R. 6410

I want to emphasize that we have not had time to fully analyze the impact of all of the provisions of H.R. 6410. However, we have concluded that the bill would:

Reduce the incentive for employees to provide for their own retirement through contributions to corporate savings plans.

Add significantly to the existing problems of the Social Security System as a result of weakening the private pension system.

Discriminate unfairly against the participants and beneficiaries of private plans in favor of those covered by Congressional, Civil Service and other governmental plans.

Adversely affect the creation of long-term investment capital.

Impose a complex and punitive system of procedures for coordinating private pensions and Social Security benefits on young and middle aged adults.

Add to the already burdensome reporting and filing requirements currently experienced by American business.

While time will not permit a section-by-section review of H.R. 6410, it is appropriate to point to several examples of how this bill has failed to recognized the adverse policy implications of its provisions. Some of the other testimony, no doubt, will emphasize points not covered by us.

1. Elimination of the 1.4 Rule.—Prior to ERISA, there were no real restrictions on the benefits which could be provided through two or more plans. In effect, the "pre-ERISA" rule was 2.0. The decision to allow employers to provide benefits at the current 1.4 level recognized several important factors. First, employers that went beyond the 1.0 level did so because they sponsored defined contribution plans—usually involving employee contributions. These plans often serve purposes beyond the mere accumulation of funds for retirement. Typically, employees can withdraw funds to cope with major financial events in their lives, such as, home purchases or college education. However, funds intended for purposes other than retirement are still fully charged against the 1.4 limits.

A second reason for the 1.4 rules lies in the fact that employee contributions are so frequently associated with defined contribution plans. Many employers sponsor these plans specifically to attract employee contributions. Recent changes in the Internal Revenue Code and new regulations have caused a very encouraging new interest in plans which provide for employee deferrals of income for purposes of long-term investment. The elimination of the current 1.4 rule could deal a severe blow to those new efforts aimed at beefing-up the two legs of the retirement stool other than the Social Security System. Employee contributions for their own retirement benefit might reduce their employer-provided benefits—on a dollar-for-dollar basis—under a 1.0 system, making such programs very unattractive to employees.

This bill would also reverse the direction of public policy in another area with respect to these plans. For example, the provision to treat loans to all employees in section 401(k) cash or deferred plans as taxable distributions might cripple those plans—many of which are already in place or about to become effective. Thus, this legislation would discourage defined contribution plans at a time when sound public policy demands that they be encouraged. Contributory plans form a vitally important component of our retirement system. Individuals should be encouraged to save for their own retirement, especially in view of the uncertainties surrounding the future of the Social Security System.

In addition, defined contribution plans almost invariably contain features that are favorable to participants, such as early vesting and portability of benefits. They are currently among the best understood and most appreciated of retirement programs. This bill would unfortunately weaken the self-help concept, making these programs less effective.

2. New Social Security Integration Rules.—The changes proposed in the Social Security integration rules are a vivid example of the lack of full policy consideration with which H.R. 6410 appears to have been developed. Consistent with the bill's apparent intent, the integration rules would reduce the level of allowable Social Security offset drastically for employees who terminate employment at what is typically called "retirement age." However, for almost all employees currently under age 45 or 50, the bill's rules could increase substantially the allowable integration and the amount of their pension that could be offset by their employer. The impact of the latter could permit defined benefit plans to reduce or eliminate the level of vested benefits for the younger members of the work force. We doubt that this is a result intended by the bill's authors.

Sound public policy in this area for defined benefit plans should focus on the coordination of benefits provided by Social Security and private pension plans not on contributions or who pays what taxes. Retirees live on benefits paid by private plans and Social Security, not on the contributions or taxes paid into those programs. The taxes paid today for OASDI were designed only to match revenues attributable to current workers with payments to current beneficiaries. The taxes for current workers bear no relationship to the cost of benefits which they will ultimately receive. The deceptively simplistic solution offered in the bill in focusing on taxes paid has irrational results in terms of the benefits which would be provided by private pension plans.

Furthermore, there should be a single set of integration rules, not two. The two sets of rules which the bill would permit—one for current plan participants and another for new participants—would force employers to establish separate benefit structures since the concern of employers will be for the coordination of benefits. The separate structures would present grave problems to employers with more than one plan when the need arises to transfer an employee from division to division or hourly to salary status when as a result of the transfer the employee would be a new participant in another plan.

In addition, the rules in the bill for defined benefit plans would result in increased administrative cost, particularly in keeping track of the OASDI tax paid for each employee. Also, there would be the need, as well as the added cost, to prepare and distribute different summary plan descriptions for the employees covered by different benefit rules.

By cutting back so drastically on the integration for older employees and applying the new rules only to new plan participants after December 31, 1983, the bill would create a substantial economic incentive for employers not to hire older workers. This is clearly contrary to the policies which the Congress has attempted to encourage.

3. Other Employee Benefit Programs.—The proposed rules for statutory fringe benefit plans (including group insurance plans) have the potential for becoming a bureaucratic monster. Plans would most likely have to seek qualification and follow various IRS regulations, rulings, etc. In the aggregate, one-time costs to seek initial qualification could easily run in the billions and ongoing costs would likely be in hundreds of millions. In our view, the costs would far outweigh the benefits.

Great efforts are being made today to reduce the regulatory burden on business. However, this proposed legislation goes in the opposite direction. Current pension regulation is already incredibly complicated and burdensome. Adding more regulation in the fringe benefit area would further increase these burdens.

The fringe benefit provision probably would not increase revenues but, on the contrary, is more likely to decrease revenues as a result of higher employer costs and some expanded coverage because of the nondiscrimination provisions. It is true the nondiscrimination provision would eliminate discrimination in some plans—particularly top-hat health insurance disability plans and insured discriminatory medical reimbursement plans. However, this problem, in our view, is small compared with the much larger problem of creating another bureaucratic monster.

CONCLUSION

As can be seen from just these three examples, there are major thrusts of H.R. 6410 which are in direct conflict with well established national policy. We would respectfully ask the Committee to carefully consider the following questions: (1) Would this bill really increase revenues significantly? (2) Does it really establish greater equity? (3) Is the full impact of this bill on rank and file employees really understood?

Our initial analysis in the revenue area alone, suggests that the tax deductible costs of employer compliance with its provisions would exceed any revenue enhancement which might be generated by H.R. 6410. We are convinced that equity among plan participants is not measurably enhanced. We suggest that this bill is not in the best interests of the world of employee benefits.

Mr **DEARNLEY**. I will shorten my comments to say that the full statement that treats this more extensively and also comments that relate to the other fringe benefit programs and commendation.

But that can be seen from these examples and others in our submitted testimony, we feel that the major thrust of H.R. 6410 are in direct conflict with well-established national policy. We would respectfully ask the committee to carefully consider the following questions:

Would this bill really increase revenue significantly? Does it really establish greater equity? Is the full impact of this bill on rank-and-file employees really understood? Our initial analysis in the revenue area alone suggests that the tax deductible cost of employer compliance with its provisions would exceed any revenue enhancement which might be generated.

We are convinced that equity among plan participants is not measurably enhanced. We suggest that this bill is not in the best interests of anybody.

Chairman **ROSTENKOWSKI**. Mr. Mentz, you may proceed.

STATEMENT OF J. ROGER MENTZ, CHAIRMAN, TAX SECTION, NEW YORK STATE BAR ASSOCIATION

Mr. MENTZ. I am Roger Mentz, and I am chairman of the New York State Bar Association Tax Section. It is my pleasure to testify today before an all-New York Ways and Means Committee.

The tax section has over 2800 members, all of whom are lawyers with a professional interest in taxation. In April of this year, the tax section executive committee approved a report on the incorporation of lawyers and law firms, that is this report here, which was made available to the Ways and Means Committee.

I must say, had I foreseen what was going to happen, I am not sure I would have gotten so deeply involved in this report. Anyway, here I am.

I offer testimony this afternoon with respect to section 5 and 6 of the bill, which are basically the subjects being dealt with very intensively in the report.

The report contains a principal recommendation on page 178 and that recommendation is that Congress establish legislative parity for qualified plans applicable to self-employed individuals, that is, parity with corporate plans, generally.

Based on that recommendation, the tax section is opposed to section 5 and 6 of the bill, in their present form, but the tax section believes that this bill is a vehicle that could very well result in the type of legislative parity that we have recommended, and therefore, we are most interested in the legislation.

Just to review generally where we are, the present law involves a two-track system for qualified plans. There is one track for corporate plans generally, and there is a second, lower track with restrictive provisions that applies only to self-employed individuals.

The tax section finds no tax policy reason for this two-track approach. But the result of the two-track approach has been that over the years, individuals who have been self-employed have incorporated.

And they have incorporated for the purpose of jumping from the lower track to the higher track. That is the fundamental reason. The tax section's position is there shouldn't be a necessity to incorporate in order to get from the lower track to the higher track. There ought to be one basic track.

Everybody who works for a living, who earns his money by the sweat of his brow, if you will, ought to have the same basic qualified plan benefits. That is the reason for our principal recommendation.

The legislative response in H.R. 6410 goes, in some respects in the direction of parity, but in other respects it pulls back away from parity.

Certainly, the increase in the deductible limit from $15,000 to $30,000 is a step in the right direction, although we point out that that $30,000 in section 5 is not the same $30,000 as appears in section 2, applicable to corporate plans generally. But that is on defined contribution plans.

There really isn't any change in the bill relating to defined benefit plans that would modify the two-track approach, and the two tracks are very far apart in the case of a defined benefit plan. I suggest to you that unless something is done in this regard, unless there is some narrowing of the gap, there is always going to be a pressure for incorporation. Defined benefit plans benefit the very same people in any organization, the senior, long-service employees; because of the past service provision that is possible under corporate plans, but not possible in an H.R. 10 plan, the tracks are far apart. If something isn't done to correct that disparity, there is going to be inevitably a continued pressure for incorporation.

About all I want to say about section 6 is that it is arbitrary to draw any kind of a line between personal services of one kind or another. The way section 6 is right now, an author, an artist, or a diamond cutter could incorporate and provide very substantial benefits under track one, and yet a law firm of 500 persons, incorporated or not, would be relegated to track two.

Mr. Rangel, we certainly agree that discrimination against rank-and-file is a proper subject that you and this committee should be considering. Certainly, ERISA and the Kiddie-Garland legislation that was enacted in 1980 dealt with that subject. If you want to deal with it further, we agree that is proper. In starting out, we think you ought to look at it as a one-track approach, not a two-track. Apply one set of rules to all organizations. Otherwise, you have the anomaly of a 5,000-person accounting firm that is not incorporated treated possibly differently than a five-person corporation, which doesn't make very much sense.

Just to summarize very quickly, the Tax Section feels that Section 5 ought to be modified to go to a full parity approach, a one-track approach. If you did that, that would result in simplification which you, Mr. Conable, mentioned at the beginning of the hearing.

It would clearly also be in the interest of pension equity. And if you did that, you really wouldn't have to deal with section 6 because—you wouldn't have to try to cut that very difficult arbitrary line, determining what personal services are in or are out.

I would like to say on behalf of the tax section as has been our practice in the past, we would be pleased to work with the Joint Committee staff, the Ways and Means staff, and anyone else on this very complex and difficult legislative subject.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF J. ROGER MENTZ

Mr. Chairman and members of the Committee, my name is J. Roger Mentz. I am the Chairman of the New York State Bar Association Tax Section. The Tax Section has over 2,800 members, all of whom are lawyers with a professional interest in taxation. They include practicing lawyers, teachers, corporate counsel, and officials and employees of the Treasury Department and the Internal Revenue Service. It is my privilege to testify before you today on H.R. 6410, the Pension Equity Tax Act of 1982.

My testimony is directed to Sections 5 and 6 of the Bill,[1] which deal with the treatment of retirement plans for self-employed individuals and plans of certain "personal service corporations". These subjects were considered by the Tax Section in its Report on the Incorporation of Lawyers and Law Firms issued in April 1982. The Tax Section opposes Sections 5 and 6 in their present form because they are inconsistent with the basic recommendation of the Tax Section, at page 178 of the Report, which is as follows:

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[1] The Tax Section is considering the other provisions of the Bill and expects to submit a Report thereon.

"It is the recommendation of the Tax Section that . . . Congress establish legislative parity of self-employed qualified plans with corporate plans. . . ."

We believe this position to be one of fundamental equity. Current law establishes a two-track set of legal rules governing qualified plans. One set of rules applies to all corporate qualified plans. The other, more restrictive and complex, applies to all self-employed individuals, with even more restrictive provisions applicable to 10 percent owners of the unincorporated business. The result is substantial differences in the tax treatment afforded to retirement plans established for individuals in substantially the same circumstances, distinguished only by whether the legal steps have been taken to incorporate. We have not found any rationale for this present distinction or any tax policy reason for it. Elimination of the disparity between self-employed individuals and corporate employees would simplify the tax law by eliminating one entire set of complex rules, and would be equitable, in that individuals who earn a living by performing personal services would be treated the same, irrespective of the legal status of their employer or of the nature of their business.

The Bill would not eliminate the disparity. Indeed, many of the rules for self-employed plans would be made more restrictive, thus widening the gap between self-employed and corporate plans. Further, Section 6 would distinguish among corporate employees according to whether they earn their income from performing certain designated personal services, and thus would create a new disparity.

Nevertheless, H.R. 6410 may well be the legislative vehicle to eliminate the inequitable distinction between qualified plans for the self-employed and similar plans for corporations generally. Surely its title proffers that expectation. In order for the promised equity to materialize, however, the Bill would have to be modified. An analysis of the differences between self-employed and corporate retirement plans, assuming adoption of the Bill in its present form, will serve to illustrate this point.

BENEFIT LIMITATIONS

Section 5(a) of the Bill would increase the permitted deduction for contributions to self-employed defined contribution plans from $15,000 a year to $30,000. While this change superficially appears to conform to the proposed change in the corporate limitations for defined contribution plans to $30,000 as provided in Section 2 of the Bill, in fact substantial disparity would remain. First, under a self-employed defined contribution plan, only annual compensation up to $200,000 may be taken into account, whereas there is no limit on the amount of compensation that may be considered in a corporate plan. Second, the deduction for self-employed individuals is limited to 15 percent of compensation, whereas corporate deductions to defined contribution plans may in the aggregate be up to 25 percent of compensation. These distinctions between plans for self-employed individuals and corporate employees should not exist.

In the case of a defined benefit plan, although the Bill would increase the amount of annual compensation taken into account from $100,000 to $200,000, the Bill fails to correct a substantial disparity that exists today. Under current law, which would not be altered by the Bill, there is no effective means of providing past service credit for a self-employed person for service with his employer prior to the adoption or improvement of a plan, as is possible for a corporate employee. In essence, a defined benefit plan for a self-employed person with substantial past service will provide a greatly inferior benefit than that provided by a corporate plan for a similarly situated corporate employee.

The correct policy answer on the subject of benefit limitations is to provide the same limitations for all plans, whether for self-employed or corporate individuals, in Section 415 of the Code, and to delete all of the special limitations for self-employed plans.

VESTING

Under present law, the vesting rules for self-employed plans that do not cover owner-employees are the same as the corporate vesting rules. Under Section 5 of the Bill, however, this state of parity would be upset, and immediate vesting would be required for all participants in any self-employed plan. We do not perceive the tax policy served by such increased disparity. Modification of the vesting rules for only self-employed individuals would in our view be discriminatory and inequitable.

COVERAGE

The Bill would substantially tighten the coverage requirements for all self-employed plans by generally requiring coverage of every person, not just coverage on a non-discriminatory basis or coverage of 70 percent or more of all employees. This would increase the disparity from the usual corporate coverage rules. We perceive no tax policy justification for this discrimination.

MISCELLANEOUS

There are numerous other examples where the tax treatment of self-employed plans is inferior to that of corporate plans, and some of these would be worsened by the Bill—these include the prohibition against payment of benefits prior to attaining age 59½, which under the Bill would apply to all self-employed individuals, not just owner-employees. In addition, as a policy matter we see no reason why a self-employed individual should not be entitled to receive a lump sum distribution upon a complete separation from service; yet that is the state of the law today. We submit that truly equitable treatment requires parity in these respects as well, and that the equitable solution could be achieved through a simplification that would delete the many complex provisions relating to self-employed plans.

It may be that at one time there was a legitimate concern that certain service organizations could arrange their affairs so as to deprive rank and file employees of pension benefits. As a result of the enactment of ERISA and Section 414(m) of the Code in 1980 (the "Kiddie-Garland" legislation), the possibilities for such discrimination are essentially eliminated, even if the organization or its members choose to operate in corporate form. Thus, at present there is, in our view, no policy justification for continuation of the two-track approach.

"PERSONAL SERVICE CORPORATIONS"

Section 6 of the Bill would extend the inequitable two-track system by imposing the self-employed plan rules on certain "personal service corporations" whose principal function is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics or consulting. It is unclear on what basis the distinction is being made between corporate employees who perform one type of service function and other types of corporate employees. What tax policy difference exists between a law firm that employs 200 individuals, many of whom are secretaries, clerks, paralegals, and other nonprofessionals, from a 200-person corporation which is engaged in a manufacturing or other business? On what basis is such a distinction defensible? Is the personal service corporation more likely to discriminate against its employees, even after the enactment of the Kiddie-Garland legislation in 1980 which precludes discrimination among affiliated service organizations? And indeed, why should other personal service corporations not be included, such as insurance and real estate salesmen, authors, photographers, diamond cutters, pilots, artists, etc. Obviously, the delineation of certain personal service functions for purposes of radically discriminatory pension treatment will necessarily be arbitrary.

It is an unfortunate testimony to the discriminatory status of our pension laws that self-employed individuals have been, and are being, forced to incorporate in order to attain the same qualified plan benefits for themselves and their rank and file employees [2] as those available to the corporate business community in general. It is equally unfortunate that the legislative response to this phenomenon in the Bill is not to eliminate the discrimination and thus remove the inequity, but rather to widen the disparity and deny those who are functioning in corporate form the same benefits of qualified plans enjoyed by the rest of corporate America.

CONCLUSION

In summary, it is the basic position of the Tax Section that Section 5 of H.R. 6410 should be modified to establish parity between qualified plans for self-employed individuals and plans for corporate employees, and that Section 6 of the Bill should be deleted. This solution would eliminate the unfair discrimination that exists in current law between qualified plans, and would also eliminate the problem of justifying the arbitrary classification of "personal service corporations". In short, it would promote simplicity by eliminating many complex Code provisions, and would truly result in pension equity.

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[2] Frequently professional incorporation results in an upgrading of pension benefits for all employees, including the rank and file.

Thank you.

Mr. RANGEL. We welcome and accept your offer.

Mr. Conable.

Mr. CONABLE. I thank you, Mr. Mentz, particularly for being here. I have worked with the bar association on many issues in the past and appreciate your thoughtfulness on the subject. I have not heard all of the testimony of this panel, but there has not been any discussion on the issue of borrowing that I have heard.

Are there conditions we should impose on the ability to borrow against retirement plan funds? As you know, that is an issue addressed by this proposed legislation.

Mr. Mentz, would you care to start on that?

Mr. MENTZ. Well, I am afraid my charter doesn't extend to that question since it is not part of sections 5 and 6. I can give you my own personal view.

Mr. CONABLE. Yes.

Mr. MENTZ. It is along the lines of that testimony I heard by John Nolan. Borrowing from plans only in—except in very rare circumstances, should be severely limited. Otherwise, you impact the integrity of the funding of the retirement plan.

But that is purely a personal opinion, not just the tax section view.

Mr. HALPERIN. I certainly would agree with that. There are two separate questions. One whether we should have early distribution from a retirement plan in the form of borrowing or otherwise. As was suggested earlier, we ought to limit that as much as we can.

To the extent we feel that there are some circumstances where early distributions would be proper, the second question is whether those distributions should ever be nontaxable.

About the only reason I can see for allowing something to be treated as a loan, as opposed to a taxable distribution, would be the hope that the loan comes back relatively quickly.

Mr. CONABLE. So there should be some short——

Mr. HALPERIN. On the other side is the real abuse of somebody having a tax deduction and having the money in hand, and then paying himself deductible interest and receiving the interest nontaxable. That is awfully hard to swallow.

Mr. CONABLE. This has some impact on whether it is a factor alone or——

Mr. HALPERIN. One thing you can do is require that the interest be zero and the money be allocated only to the individual's account. At least there he is not getting a tax deduction in addition to nontaxed receipt of his money.

There is no reason to pay interest since it is going to himself as long as it is not affecting the other employees' interest in the fund.

Mr. KUBICZKY. May I address the issue of borrowing? I agree with the comments from both of the gentlemen of New York and Jack Nolan this morning.

I personally am not in favor of borrowing. But I am a little bit surprised at the inclusion in this bill of specific rules that would treat borrowing or, for instance, the 15 percent highest compensated people in a plan, which could take into account a number of people that aren't within the prohibited group.

The IRS for a number of years has had rules, several rules that could be used to monitor and regulate the abuses that could be attached to borrowing. For instance, there was the constructive receipt rule, that was repealed in ERDA, that is still carried along to some extent, and there is also the exclusive benefit rule for the maintenance of these plans.

The vigorous enforcement of those rules in abusive situations, I think, could probably go a long way to regulate in the area without a need for specific legislation which just complicates things.

Mr. CONABLE. Thank you. If there are other answers, I will be happy to read them in the record. I am sorry to say I have got to go over to the floor.

Mr. RANGEL. Mr. Vander Jagt?

Mr. VANDER JAGT. No questions.

Mr. RANGEL. Mr. Dearnley, other members of the panel have a problem with this integration question, and so do I. I think your testimony indicates that we should not be concerned with employer contribution, but we should be concerned with the benefits that the employee will be entitled to.

Is that basically your position?

Mr. DEARNLEY. The point I was making is that the relationship between the taxes paid for social security and the benefits is that there essentially isn't any.

So that what is important from the standpoint of the employee, or the retiree, is the benefits that he gets that are a combination of private benefit plan and social security.

Mr. RANGEL. Even if the employer had nothing to do with that benefit?

Mr. DEARNLEY. I don't understand how the employer would not have anything to do with the benefit.

Mr. RANGEL. Suppose we eliminate the social security system and we substituted private annuities that the employee was able to get from prior employers, there is no question that he would receive at age 65 substantial benefits. The last employer had nothing to do with these benefits, the last employer made no contribution to previous pension plans or previous benefits.

You would not say that the last employer should take into consideration what benefits the employee is to receive outside of the pension plan, and then just add to that, because the employee is only concerned with the total. You wouldn't say that?

Mr. DEARNLEY. Inherently, if he does——

Mr. RANGEL. You are not saying if I come to work for your firm and I bring with me my congressional pension, that when you look at what you are going to give me, that you are going to look at my congressional pension and then add on that?

Mr. DEARNLEY. Absolutely not.

Mr. RANGEL. Because you didn't contribute to my pension plan, right?

Mr. DEARNLEY. That is right.

Mr. RANGEL. So when you don't contribute to my social security plan, why should you charge off prior contributions to your plan?

Mr. **Dearnley**. Well, you confuse me by this point, because you have made it several points. Now, there are many plans and the Citibank plan is one of them. Where our social security offset is a function of the employee service with us, we only take the full social security offset, which is 50 percent, the maximum, if the individual has been with us for 30 years.

So we are not—we are not, and many others are not, I believe, taking advantage of social security contributions made by other employers.

Mr. **Rangel**. Then how could you help us to hammer into law a plan that would do what you are doing. That is a plan to avoid the abuse where employers are indeed charging off prior employer contribution?

Mr. **Halperin**. What you need, Mr. Rangel, is to relate the offset to the period for which the benefit is given. If an employer is able to give somebody who worked for them for 10 years as much as somebody who worked for them for 30 years, I have no objection to a full offset in either case but they ought not to be able to give 10 years' worth of benefit in the plan and take 30 years' credit for social security.

Mr. **O'Farrell**. May I speak to that issue? Because it is something I studied quite a bit.

Mr. **Rangel**. You will be able to tell me why it makes sense to take advantage of 30 years of working when he has worked with you for only 10?

Mr. **O'Farrell**. Please don't put words in my mouth, sir. The intent behind integration, and I would agree with Mr. Halperin's last point entirely, I think the bill endangers plans that do give proportionately greater plan benefits and corresponding social security offsets.

The principle should be that the employer may consider in the plan benefit the portion of the ultimate social security benefit that is attributable to service with that employer, or, that corresponds to the level of plan benefits, whichever is greater.

I don't know exactly at this point, after 2 weeks of time to look at it, and I don't think it is a question that can be studied adequately in 2 weeks or a month. But the contribution basis on which the bill is constructed for a benefit-based system will create disparities of treatment among similarly situated rank-and-file employees who are similarly situated as to income, but are of different ages and service periods.

The contribution basis can't work to do what you are trying to accomplish. It will have the effect of reducing benefits proportionately in the mass of plans if you try to apply it to a benefit-based system.

Mr. **Rangel**. We thank the panel, and advise you that the record is open for any additional suggestions you would like to make.

[The following was subsequently received:]

New York State Bar Association,
Tax Section,
New York, N.Y., June 22, 1982.

Re H.R. 6410
Hon. John E. Chapoton,
Assistant Secretary for Tax Policy,
Department of the Treasury, Washington, D.C.

Dear Mr. Chapoton: On behalf of the Tax Section, I wish to offer the following comments on your testimony presented to the House Committee on Ways and Means on June 10, 1982 as it related to Sections 5 and 6 of H.R. 6410.

1. Parity Between Corporate and Noncorporate Plans Generally.

The Tax Section is pleased that the Treasury Department supports the goal of parity between corporate and noncorporate plans. We also concur with your position that H.R. 6410 would not create parity, and that a new distinction between personal service corporation and self-employed plans, on the one hand, and corporate plans on the other would be as unsatisfactory as the present system.

2. Contribution Percentages and Amounts.

We would have no logical complaint if the current $200,000 limit on earned income that may be taken into account in determining contributions and benefits for self-employed individuals were imposed on all qualified plans. We question, however, whether it is feasible or desirable to impose a limitation of $200,000 of income on all qualified plans in America. If, in fact, no such limitation is applicable to qualified plans generally, then, under what I believe is your concept of parity as well as others, the $200,000 limitation should be removed from self-employed plans.

We concur with footnote 4 of your testimony that a 20 percent contribution for self-employed individuals is the same as a 25 percent contribution for corporate employees.

We agree with your suggestion that a definite formula for determining contributions to defined contribution plans should be deleted as a requirement for all plans.

3. Defined Benefit Plans for Self-Employed.

Your recommendation that Section 401(j)—which under limited circumstances allows a self-employed person to participate in a defined benefit plan—be deleted could pose a substantial problem. If your suggestion means that the same rules that apply to defined benefit plans for corporate employees would also apply to defined benefit plans for self-employed persons, we would agree, as this would constitute parity. If, however, your thought is to eliminate any self-employed person from being covered by a defined benefit plan, this would result in severe disparity. Exclusion of defined benefit plans for the self-employed could only cause additional pressure on sole proprietors and partners to incorporate. As I testified at the Ways and Means Committee hearing, this is a very important point that should be addressed in any pension reform legislation. Furthermore, Section 401(j) in its present form is not satisfactory in that it has no mechanism for effectively providing past service benefits for self-employed individuals whose service was rendered prior to the adoption of the plan. This defect should be remedied, and parity with respect to defined benefit plans should be achieved, or the rules for self-employed individuals will become moot as they are forced to incorporate to obtain the advantages of defined benefit pension plans. Because the Tax Section does not believe that it should be necessary for a person to incorporate in order to enjoy the qualified plan benefits available to the rest of the American corporate business community, we feel that the suggested deletion of Section 401(j) is an unacceptable one, and that a parity solution should be developed.

4. Vesting.

Consistent with our testimony and our position on parity, we strongly agree with you that imposition of the three-year/100% vesting rule to all self-employed individuals would be inappropriate.

5. Distributions.

We do not disagree with your suggestion that restrictions might properly be imposed on distributions from corporate and noncorporate plans. We do object to the imposition of such a restriction only on noncorporate plans. The same comment applies to the requirement that an entire interest in the plan be distributed within five years of the death of the employee and his or her spouse. If such rules are to be imposed on all plans, as a considered judgment of Congress, then so be it, but we do object to the imposition of such rules only on the self-employed.

6. Discrimination by Type of Business.

As indicated in our written testimony, we strongly agree with you that the level of retirement benefits, or the structure of the retirement plan, should not depend on the trade or business in which an individual is engaged. The approach of H.R. 6410 would subject certain "personal service corporations" to the same treatment regarding qualified plans as applicable to self-employed. This arbitrary approach, based solely on the nature of an individual's business, is unfair and would be the subject of many factual disputes in practice.

7. "Key Employee Plans."

Your suggestion that "key employee plans" be subject to many of the present rules governing owner-employee plans is troublesome and will undoubtedly become controversial. This suggestion raises difficult transition questions. For example, what rules would apply if a plan had 49 percent of its accrued vested benefits for key employees for all years except one, in which the percentage went to 50 percent? Would immediate vesting then be required for all future years, even if the accrued benefits for key employees thereby became less than 50 percent? This provision could result in a plan flip-flopping in and out of the "key employee plan" designation.

The Tax Section believes that this suggested approach will not be productive of effective legislation. We think that the better approach, as I stated in my oral testimony, would be to explore the problem of discrimination with a view to providing uniform rules that apply to all plans to protest against discrimination. Thus if, for example, it was the determination of Congress that the vesting rules in Section 411 should be tightened, this should be done for all plans, across the board. Any attempt to distinguish between types of plans, whether based on form of organization, type of service, or percentage of key employees in a particular plan, will necessarily be arbitrary and add substantial complexity to an already complex law.

I wish to renew the offer made in my testimony on behalf of the Tax Section that we will be pleased to work with the Treasury, the Joint Committee Staff, and the Members and Staff of the Ways and Means Committee and the Senate Finance Committee in order to assist on this very important legislative endeavor to achieve pension equity.

Very truly yours,

J. ROGER MENTZ.

Mr. RANGEL. The next panel, American Academy of Actuaries, Douglas Borton, chairman of the Pension Committee; Employee Benefit Research Institute, Dr. Sylvester Schieber, research director; Employers Council on Flexible Compensation, Carrol J. Savage, counsel; and National Association of Pension Consultants and Administrators, Paul Abbott, vice president; Women's Equity Action League, Patricia Blau Reuss, legislative director.

Chairman Borton?

STATEMENT OF DOUGLAS C. BORTON, CHAIRMAN, PENSION COMMITTEE, AMERICAN ACADEMY OF ACTUARIES

Mr. BORTON. Thank you, Mr. Chairman. For the record, my name is Douglas C. Borton, chief actuary of Buck Consultants in New York.

Today, I am testifying on behalf of the American Academy of Actuaries, for which I am chairman of the pension committee. We at the academy appreciate the opportunity to testify on the bill. The academy, as you know, has submitted written testimony which is limited to its actuarial aspects.

I would like to briefly summarize some of the points we made in this testimony.

Mr. RANGEL. Your full statement will be entered into the record,

Mr. BORTON. Thank you.

The two actuarial areas which we have addressed in our written testimony concern the integration of pension plans with social security and the proposed reductions in the maximum benefit limitations.

I will talk about integration first. We admit that the current social security integration requirements are complex and are in need of simplification. They tend to be outdated, most notably they fail to recognize the major changes in social security benefit levels which arose as a result of the 1977 Social Security Amendments.

However, despite these weaknesses, the existing integration rules have been in effect for a number of years and have operated reasonably successfully. Because of their complex nature, as has been pointed out by a number of previous speakers, we feel that changes in the integration rules should be approached with caution and should involve considerable study and analysis.

This doesn't appear to be the case with the proposals in H.R. 6410. We see problems with the approach in the bill. One is that, with the exception of the safe harbor provision, it appears the bill's integration proposal for defined benefit plans is only applicable to offset plans.

There don't seem to be specific provisions for integrating step-up benefit plans. Also, under the proposals, the maximum offset would be the amount of benefit that could be purchased with the accumulated value at age 65 of the employer-paid taxes.

We see some problems with this. There is no direct relationship between the taxes paid by the employee or the employer, and the benefit amount paid to the individual at retirement.

Also, any accumulation of past taxes would be very sensitive to the interest rate used for this purpose.

It should be pointed out that current integration rules are based on an averaging concept, while the proposed law would put such rules on an individual basis. We agree that there is justification for recognizing an individual's period of employment with a particular employer in determining the maximum level of integration, but we have considerable difficulty with the practical approach of doing this on an individual basis and relating the offset to the past social security taxes.

We also are confused about where the $30,000 and $60,000 break points came in the safe harbor provision, since the current taxable wage base is $32,400. It doesn't seem to be clear whether these same types of limitations would apply to both final pay and career average plans.

Finally, with respect to the integration rules, we note that there is a grandfather provision for defined benefit plans, which would permit retention of existing integration rules for those who became plan participants before 1984 with the new rules applying for participants hired after that.

This seems to be a good idea, but there is a question of the practicality of an employer running two different retirement plans for employees working side by side. This generally creates problems and leads to duplication of administration in tax filing materials and so forth.

In the benefit limitation area, we have only a couple of comments. We will limit our comments to indexation and the actuarial equivalent adjustments for early retirement.

We don't feel it is appropriate for us to comment on the amounts of the proposed benefit limitations or even whether there should be such limitations because these are social policy issues and not actuarial issues.

The removal of any indexing will result in continually reducing real limits after inflation, which will produce greater and greater restrictions with the passage of time. This would be inconsistent with the indexing which Congress has legislated for social security and for the major Federal employee retirement systems.

Also, the required actuarial reduction and benefit limitations for retirement before age 65 seem harsh to us, particularly since the Federal employee retirement systems and many retirement systems in the private area provide for unreduced benefits before age 65.

In conclusion, we feel that legislation in the pension area is very complex. It has certainly been a long and difficult period since ERISA was passed and we just seem to be getting around to the point where things are reasonably in order. It is a concern to us that we are today discussing such sweeping proposals with little or no prior consultation or advice from the private pension community.

Less than one month has been given for the analysis of the bill's ramifications and we wonder whether this is the way to obtain the best possible pension legislation.

Thank you.

[The prepared statement follows:]

STATEMENT OF DOUGLAS C. BORTON, ON BEHALF OF THE PENSION COMMITTEE OF THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries ("Academy") appreciates the opportunity to testify on H.R. 6410, the Pension Equity Act of 1982. These comments are being offered on behalf of the Subcommittee on Tax Matters of the Pension Committee of the Academy.

Academy members are vitally interested in this bill since a large segment of our membership consists of actuaries providing services for private pension plans in this country. Over 80 percent of the enrolled actuaries under ERISA are members of the Academy. Attachment A contains additional background information about the Academy.

We will confine our testimony today to actuarial aspects of the bill; other aspects of the bill are being extensively discussed by other witnesses. However, since the introduction of this bill, we have received an outpouring of concern from our membership. In fact, the concerns we have heard from our members are the most extensive on any proposed piece of pension legislation during the post-ERISA period.

Legislation in the pension area is quite complex and thus is one of the most challenging areas for the Congress to deal with effectively. The long and difficult period following the passage of ERISA in 1974 is ample evidence of just how difficult, sensitive and complex an area this really is.

For several years now, extensive efforts toward a comprehensive ERISA improvements bill have been underway. This has resulted in the Retirement Income Incentives and Administrative Simplification Act (S. 1541 and H.R. 4330). These two bills and their predecessors have received extensive analysis and commentary over a period of time which has allowed many desirable improvements to be incorporated. We feel that this process is the proper road to good legislation in such a complex and difficult area as pensions.

And yet here we are today discussing a sweeping proposal which has had virtually no input from the private pension community and for which much less than even one month has been granted for analysis of the bill's ramifications (which we believe are extensive). We seriously question whether this is the way to obtain thoughtful and effective pension legislation.

It is well documented that ERISA had an unintended and unexpected adverse effect on plan terminations and new plan formations from which the private pension system is only recently recovering. However, this proposed bill might well cause another round of increased plan terminations and reduced new plan formations. The present environment is not the time to introduce a new deterrent to the private pension system, particularly in view of the financial difficulties facing Social Security. There is little doubt that greater reliance on the private pension system in the future will be necessary regardless of how the current Social Security difficulties are resolved by Congress. This fact coupled with the demonstrated need for more private investment capital, which our economy needs and which private pensions can deliver, make this a most inopportune time to hamper the development of the private pension system.

There are two specific areas of the bill we would like to address. The first is the reduction in maximum benefit limitations Let us preface our remarks in this area with the observation that the level at which these should be set (if, indeed, they should exist at all) is a social policy issue and not an actuarial one. Therefore, we will not comment on the proposed level of these limitations.

However, we would offer the following general observations about the proposal:

1. The apparent motivation of the bill is to reduce the benefits for highly paid employees. However, what is apparently overlooked is the fact that across-the-board reductions affecting the rank-and-file employees as well as the highly paid employees will frequently be the result of this proposal.

2. The removal of any indexation will result in continually reducing "real" limits (after inflation) which will produce a greater and greater restriction with the passage of time. This seems inconsistent with the indexation which Congress itself has legislated for Social Security and for the major federal employee retirement systems.

3. The required actuarial reduction in benefit limitations for retirement before age 65 seems harsh again in comparison with major federal employee retirement systems. For example, the federal Civil Service Retirement System does not impose an actuarial reduction factor down to age 55. Although many plans do in fact have actuarial reduction factors for early retirement, we do not see a rationale for mandating a reduction in benefit limitations on those plans which do not impose such an actuarial reduction for early retirement.

4. Higher paid employees would in many cases be able to do an "end run" around the new requirements by setting up unfunded deferred compensation programs. This would hardly seem to be a desirable result to encourage, since ERISA funding standards do not apply to such plans and since investment capital for the economy is not generated by such plans.

The second area we would like to address is the area of integration of plans with Social Security. There is no doubt that current Social Security integration requirements are complex and that some simplification would be desirable. Also, they are outdated in some respects, e.g., they fail to recognize the 1977 amendments to the Social Security Act.

Nevertheless, they have been in effect for a good many years and have operated successfully during this period. We seriously doubt that the "quick fix" suggested in this bill would be any improvement over the admittedly imperfect current system. This is an area that deserves considerable study and analysis before any legislation should be adopted.

The problems with the proposal are many. Among them are:

1. Any workable approach to integration should be able to be based on the benefit formula in the plan as a whole. However, this bill would set up a system in which individual calculations for each employee would be involved. This is administratively inconvenient and costly. A system by which the benefit formula in the plan can be judged as a whole is greatly preferable.

2. The results of such individual calculations would have an illogical pattern to them. For example, longer service employees would have smaller benefits than shorter service employees since the employer has paid more Social Security taxes for the former.

3. The "safe harbor" limitations of $30,000 and $60,000 seem totally arbitrary and unrelated to anything. The current Social Security wage base is $32,400 and rising each year.

4. The proposals are not definitive in how the various types of formulas (flat benefit, final average, career average, offset, etc.) would be affected. There are many unanswered questions that would require subsequent regulation to answer. In the meantime, however, considerable uncertainty and disruption would be created for plans that did not know whether they were in compliance or not.

In fact, the rationale for these proposed changes in integration requirements is unclear. Current integration requirements are already tight enough to produce a combined Social Security/private plan benefit which decreases as a percentage of pay as salary increases. Is the purpose of the proposal to require an even greater "tilt" in favor of the lower paid employees? If so, this result is in sharp contrast with the federal Civil Service Retirement System in which Social Security is not provided and which provides benefits proportional to salary.

The Retirement Income Incentives and Administrative Simplification Act (S. 1541 and H.R. 4330) contains a revised framework for Social Security integration (Section 4811). Although we are not endorsing the particular details of any particular integration formula, we find the general approach taken in those bills to be a more workable approach than that taken in H.R. 6410. We would encourage that that approach be used as a general framework to consider legislative changes in integration requirements.

In closing, we would point out that many plans would have to be amended to bring them into compliance with this bill. This is a time-consuming process resulting in significant additional administrative costs to plans. We also think that additional opportunity for analysis and commentary on the bill should be granted to those affected by it if the Congress retains an interest in legislation of this type. The time available since the bill's introduction on May 19, 1982 has simply not been adequate to ascertain all the likely ramifications and effects of the bill.

ATTACHMENT A—BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional association of actuaries which was formed in 1965 to bring together into one organization all qualified actuaries in the United States and to seek accreditation and greater public recognition for the profession. The Academy includes members of three founding organizations—the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries.

The Academy serves the entire profession. Its main focus is the social, economic, and public policy environment in which the actuarial profession functions. Its primary activities include liaison with federal and state governments, relations with other professions, the dissemination of public information about the actuarial profession and issues that affect it, and the development of standards of professional conduct and practice.

Over 6,600 actuaries in all areas of specialization belong to the Academy. These members are employed by insurance companies, consulting actuarial firms, government, academic institutions, and a growing number of industries. Actuarial science involves the evaluation of the probabilities and financial impact that uncertain future events—birth, marriage, sickness, accident, fire, liability, retirement, and death—have on insurance and other benefit plans.

Membership requirements can be summarized under two broad headings: education and experience. At present, the educational requirements can be satisfied either by passing certain professional examinations sponsored by the Casualty Actuarial Society, or the Society of Actuaries, or by becoming an enrolled actuary under the Employee Retirement Income Security Act of 1974 (ERISA). The experience requirement consists of three years of responsible actuarial work.

Chairman ROSTENKOWSKI. Our next witness is Dr. Sylvester Schieber.

STATEMENT OF SYLVESTER J. SCHIEBER, PH. D., RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. SCHIEBER. I have submitted my prepared testimony for insertion in the record.

I am pleased to appear before you to comment on the Pension Equity Tax Act of 1982. I appear before you in my capacity as research director of the Employee Benefit Research Institute, a nonprofit organization dedicated to providing research and analysis which can serve as a basis for sound policy toward employee benefits.

Prior to joining EBRI, I served as deputy director for the Office of Policy Analysis in the Social Security Administration. Before that I was Deputy Research Director of the Universal Social Security Coverage Study.

While the views I express are based on several years of research, they are my own comments. My prepared testimony makes three basic points.

First, our retirement system is a set of integrated parts. Policies that affect one part have offsetting ramifications for the others. Second, pension equity must look beyond private pensions. Finally, the last section of the testimony I raise several questions about various elements in the legislation that is being considered.

In the interest of time, I will skip through the first part of my comments and go to pension equity and taxes.

The preferential tax treatment provided to private pensions reduced Federal tax revenues by $11.3 billion in 1979, $12.9 billion in 1980, and $14.7 billion in 1981. According to the May 1979 Current Population Survey, there were more than 31 million active participants in private pensions at that time. According to the private pension filing data in response to ERISA, the actual number may be even higher. In any event, the tax incentives granted pension plans have resulted in a very large number of private sector workers sharing in these so-called tax expenditures.

Few will deny that private plans benefit from these tax incentives. Public retirement programs, on the other hand, are directly financed through tax revenues collected from the general public. Because public plans are financed by real expenditures, they should certainly enter into any discussion of pension equity issues linked to tax policy. Because of the complimentary nature of social security and pensions, the relationship of social security to public plans must also be considered.

The social security coverage issue is one that the general public does not fully understand or there would be a much greater outcry for its resolution. The problem is that roughly 2.5 million Federal workers, 3 million State and local workers, and a growing number of nonprofit employees are not covered by social security. Most of these workers will ultimately get social security benefits on an extremely preferential basis. This is often referred to as the "double dipper" problem, although that label is misleading.

In 1939, the House of Representatives report on the social security amendments of that year called these preferential benefits "unwarranted bonuses" and warned that "such bonuses are unwise and endanger the solvency of the system." The 1980 report of the Universal Social Security Coverage Study Group estimated these unwarranted bonuses windfall, were costing full career payroll taxpayers $2 billion per year. Resolving that issue is a tax equity issue.

During 1979 the Federal Government had some 83 pension plans that it administered. By comparison there were 571,000 tax qualified private sector plans. In addition, there were an estimated 500,000 KEOGH plans in existence at that time. Among the Federal plan the Military Retirement System and the Civil Service Retirement System accounted for more than 90 percent of all pension plan participants. While Federal employment comprises less than 5 percent of total employment, the Federal pension benefits in 1979 exceeded all private sector pension payments in that year.

This is a tax equity issue because the taxpayers bear the burden. If the civil service retirement system were funded on a normal cost basis, it would cost 36.5 percent of covered payroll. This would not amortize any previosuly accrued unfunded liabilities. The employees covered under this system contribute 7 percent of their earnings to the pension plan which leaves the taxpayer with a liability of 29.5 percent of payroll. In 1979 this would have amounted to $16.7 billion that taxpayers would have been required to ante up.

The military retirement system, if funded on the same basis—is totally noncontributory for those covered—would have a normal cost of 49 percent of payroll. This would have equated to a taxpayer liability of $8.9 billion in 1979 just to meet currently accruing liabilities—that is, no amortization of previously unfunded liabilities. Neither of these programs, however, is funded on this basis and the average taxpayer burden actually exceeds the normal cost estimates. The military retirement outlays alone in 1979 were $10.3 billion and were equivalent to more than 90 percent of the total tax expenditure going to all private pensions.

What would be even more disconcerting if the taxpayers understood it is the rate at which we are losing ground on Federal pensions. The unfunded liabilities in the two largest Federal retirement programs grew by $147 billion in fiscal 1980, and $129 billion in 1981. The annual growth in the present value of unfunded Federal pension obligations for taxpayers is running at 10 times the total annual tax expenditures for all private pensions.

Without doubt it is time that the Congress began to focus on pension equity and related tax issues. But that focus should not be strictly toward private plans.

It may not seem equitable to private sector workers retiring before age 65 to have their benefits actuarially reduced for retirement before age 65 when Federal workers can still retire at age 55 with 30 years of service and military workers now retiring at a median age of 39 do not receive similar reductions.

The social security integration issue, I believe, is largely misunderstood. Under contract to EBRI, Dr. James Schulz, a professor at Brandeis University and president of the American Gerontological Society is now finishing a descriptive study on pension integration. We will share that study when it is complete.

It still seems to me some comprehensive empirical work is in order in this area before it can be satisfactorily addressed. You have heard statements today that the passage of this legislation could result in substantial reductions in benefits for many private sector workers. We have not yet tried to verify those statements because there has not been time.

I do know that plan terminations, however, during the implementation of ERISA, were running three times the levels prior to ERISA and are still running much higher than they were prior to ERISA.

This does not mean that significant pension legislation should not be considered. It simply means it should be considered very carefully. That takes time, it takes analysis, it takes discussion and it takes debate.

I am not convinced that this legislation has met those criteria.

In closing, I want to thank you for allowing me to appear today and offer to give the services of our institute in assisting in any fashion we can.

[The prepared statement follows:]

STATEMENT OF SYLVESTER J. SCHIEBER, PH. D., RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE

The views in this statement are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members, or other staff.

EMPLOYEE BENEFIT RESEARCH INSTITUTE,
Washington, D.C., June 7, 1982.

Re Pension Equity Tax Act of 1982 (H.R. 6410)

Hon. DAN ROSTENKOWSKI,
Chairman, House Ways and Means Committee and Distinguished Members,
U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN AND MEMBERS: Attached, please find my statement on provisions of the above proposed legislation.

The Employee Benefit Research Institute stands ready to conduct analysis of this legislation or alternative proposals upon request.

I appreciate the opportunity of presenting views to you on this legislation.

Respectfully submitted,

SYLVESTER J. SCHIEBER,
Research Director.

Attachment.

Mr. Chairman, I am pleased to appear before you today to comment upon the Pension Equity Tax Act (H.R. 6410). I appear today in my capacity as Research Director of the Employee Benefit Research Institute. EBRI is a nonprofit organization dedicated to providing research and analysis which can serve as a basis for sound policy toward employee benefits. Prior to joining EBRI I served as the Deputy Director of the Office of Policy Analysis in the Social Security Administration. Prior to that I was the Deputy Research Director of the Universal Social Security Coverage Study, a study mandated by Congress. While the views that I express here are based on several years of research and analysis sponsored by various private and public organizations, they are my own and do not represent the official position of EBRI or any other organization.

My testimony today makes three basic points. First, our retirement system is a set of integrated parts. Policies that affect pensions or Social Security benefits or private savings affect the ability of the entire system to assure adequate retirement income security for the elderly. Second, pension equity must look beyond private pensions. The purpose of the H.R. 6410, to promote equity in our pension system is not best served by adjusting the tax treatment of private pensions alone. Finally, I wish to raise several questions about specific elements of the legislation being considered. We have not begun to assess the ultimate impact of the provisions of this bill in the context of an interdependent retirement system. Such assessments should be developed prior to the implementation of legislation that is bound to have significant effects.

RETIREMENT INCOME SECURITY SYSTEM

In our research at EBRI we have argued that decision makers should consider the following points as the make retirement policy. They should consider the existing system's structure and the relative role of its component parts. None of the elements in our retirement system exists in a vacuum. Policy changes that affect one component of the system have reverberating implications for each of the complementary parts.

It is encouraging that this fact is gaining recognition. The very establishment of the President's Commission on Pension Policy and the nature of their mandate attests to it. The fact that the National Commission on Social Security Reform has devoted considerable time to the consideration of the role of pensions does also. Each of the component elements of the U.S. retirement system has evolved in response to an economic need. There has been little coordination of this evolution, however. Both equity and economic efficiency dictate that we begin to consider retirement policy on a more comprehensive basis than we have traditionally.

Social Security is this society's joint retirement endeavor. Through it, employers and employees participate in a program that is redistributive, helping the lower-wage earner relatively more than those who earn more. It is portable, helping the mobile and stable worker alike. Historically, it has shared the benefits of growing national productivity with each wave of new retirees. It is an element of our retirement system that has become totally woven into our economic fabric.

But Social Security is not enough. Employer pensions have evolved for many reasons—some implicit, others explicit. Some pensions predate Social Security but most have come to exist since 1940 when Social Security benefits were first paid. Certainly one of the reasons that pensions have become so popular is that Social Security benefits by alone are not sufficient to meet the retirement income security needs of all members of our society.

While pensions are agreements between workers and their employers it is still in the public interest to encourage their existence and continued expansion. There are several reasons that this is so. In our economy today pensions are providing a major source of capital. They are providing benefits to rapidly growing proportions of the elderly. As they continue to expand in the future they have the potential of alleviating some of the long-term benefit pressures that the baby boom poses for Social Security. Our estimates are that by early next century more than three-fourths of all elderly households will be receiving a pension.

Social Security and pensions are both vital to the continued retirement income security of older Americans. Their roles are complementary and that reinforces the advantages of each. It is in this context that pension equity should be considered.

PENSION EQUITY AND TAXES

Without a doubt, the tax incentives provided by Congress have encouraged both the prevalence and design of private pension plans. Private employer contributions to qualified plans are deductible business expenses. Neither employer contributions nor the return on the assets in the pension fund are treated as taxable income to the participants in the pension until benefits are actually paid. Unpublished data from the Office of Tax Analysis, Department of the Treasury estimates that the preferential tax treatment provided private pensions reduced Federal tax revenues by $11.3 billion in fiscal 1979, $12.9 billion in 1980, and $14.7 billion in 1981. These forgone tax revenues are often referred to as tax expenditures by fiscal policy analysts. According to the May 1979 Current Population Survey conducted by the Bureau of the Census, there were more than 31 million active participants in private pensions during that month. According to the private pension plan filings required by Employee Retirement Income Security Act (ERISA) the actual number may be much higher. In any event, the tax incentives granted pension plans have resulted in a very large number of private sector workers sharing in these "tax expenditures."

Pension equity issues go beyond private pensions. Few will deny that private plans benefit from these so-called "tax expenditures." Public retirement programs, on the other hand, are directly financed through tax revenues collected from the general public. Because public plans are financed by "real expenditures" they should certainly enter into any discussion of pension equity issues linked to tax policy. Because of the complementary nature of Social Security and pensions, the relationship of Social Security to public plans must also be considered.

The Social Security coverage issue is one that the general public does not fully understand or there would be a much greater outcry for its resolution. The problem is that roughly 2.5 million Federal workers, 3 million State and local workers and a growing number of nonprofit employees are not covered by Social Security. Most of these workers will ultimately get Social Security benefits on an extremely preferential basis. This is often referred to as the "double dipper" problem although that label is misleading. In 1939 the House of Representatives Report on the Social Security Amendments of that year called these preferential benefits "unwarranted bonuses" and warned that "such bonuses are unwise and endanger the solvency of the system." The 1980 report of the Universal Social Security Coverage Study Group estimated these unwarranted bonuses were costing full career payroll taxpayers $2 billion per year. Resolving that issue is a tax equity issue. But the public pensions and equity issues go beyond this.

During 1979 the Federal Government had some 83 pension plans that it administered. By comparison there were, 571,000 tax qualified sector plans. In addition there were an estimated 500,000 KEOGH plans in existence at that time. Among the Federal plans the Military Retirement System and the Civil Service Retirement System accounted for more than 90 percent of all pension plan participants. In 1979 the military plan paid $10.3 billion in benefits to 1.3 million beneficiaries. The Civil Service System paid $12.5 billion in benefits to 1.6 billion in benefits to 8.7 million beneficiaries that year. While Federal employment comprises less than 5 percent of total employment the Federal pension benefits in 1979 exceeded all privator sector pensions payments in that year.

This is a tax equity issue because the taxpayers bear the burden. If the Civil Service Retirement System were funded on a normal cost basis it would cost 36.5 percent of covered payroll. This would not amortize any previously accrued unfunded liabilities but only meet currently accruing liabilities. The employees covered under this system contribute 7 percent of their earnings to the pension plan which leaves the *taxpayer with a liability of 29.5 percent. In 1979 this would have amounted to $16.7* billion that the taxpayers would have been required to ante up. The Military Retirement System is totally noncontributory for those covered and has a normal cost of 49 percent of payroll. This would have equated to a taxpayer liability of $8.9 billion in 1979 just to meet currently accruing liabilities (i.e., no amortization of previously unfunded liabilities). Neither of these programs, however, is funded on this basis and the taxpayer burden actually exceeds the normal cost estimates. The military retirement outlays alone in 1979 were $10.3 billion and were equivalent to more than 90 percent of the total "tax expenditure" attributed to all private pensions.

What would be even more disconcerting if the tax payers understood it is the rate at which we are losing ground on Federal pensions. According to the Statement of Liabilities and Other Financial Commitments of the United States Government for the end of the fiscal year 1979, 1980 and 1981 (published by the Department of Treasury, Bureau of Government Financial Operations) the unfunded liabilities in the two largest Federal retirement programs grew by $147 billion in fiscal 1980 and $128.7 billion in 1981. The annual growth in the present value of future Federal pension obligations for taxpayers is running at ten times the total annual tax expenditures for all private pensions.

THE PENSION EQUITY TAX ACT

Without doubt it is time that the Congress began to focus on pension equity and related tax issues. But that focus should not be solely toward private plans. In the context of the Pension Tax Act the estimates by the Congressional Budget Office and Department of Treasury suggest that H.R. 6410 would result in relatively small increases in total Federal revenue. In comparison to the Federal pension numbers, I have been citing they become insignificant.

If the bill cannot be justified on the basis of its "revenue enhancement" capabilities then it should be judged in the context of national retirement policy. In order to do that, it is necessary to carefully determine the relative roles, strengths and goals of each component of the retirement system.

The overall goal of these programs in combination is retirement income adequacy. The role of pensions in meeting this goal has been expanding rapidly in recent years. The number of tax qualified plans increased more than 56,000 in 1980 and more than 68,000 in 1981. Certain elements of H.R. 6410 may in fact slow down this growth. Specifically the proposed changes to the 415 limits may do so. In this case there is a need for a clearer articulation of the policy target.

Is the goal to keep income earners from shielding "too much" income from taxes? One thing that should be kept in mind is that employees benefiting from maximum contributions will probably still be subject to high tax rates in retirement. In those instances the tax treatment of pension contributions is more a tax deferral than a tax reduction. It should also be kept in mind that a large share of the "tax expenditures" attributed to pensions result from the low tax rates applied against pension benefits for retirees. These low tax rates occur largely because of the favorable tax treatment of Social Security benefits, not special treatment of pensions.

For the sake of discussion assume that the 415 limits are established at some lower level. In the pursuit of pension equity how do the proposed actuarial reductions match up with what is provided by Federal pensions? Neither the Civil Service nor military programs have actuarial reductions for normal retirement benefits prior to age 65. Under Civil Service most classes of workers are eligible for normal retirement benefits by age 55 with 30 years of service, age 60 with 20 years and age 62 with only five years. The median age at normal retirement under the military retirement program is age 39. Actuarial reductions for benefits payable before age 65 may be desirable especially in relation to discussion of raising Social Security retirement ages. But the policy must be consistent in order to be equitable.

Also the proposal for freezing the 415 limits deserves scrutiny regardless of the level at which they are set. The military and civilian Federal retirement programs are affected by two types of indexation. While those covered are working toward retirement their wages grow in two dimensions. They grow because of promotions and service increments. They also grow because of annual pay increases separate from the longevity/merit growth. As their wages grow their retirement benefits grow because in both systems benefits are calculated on the basis of earnings toward the end of Federal service. Once Federal pension benefits commence they are fully indexed for increases in the consumer price index. Private employees, by and large, benefit from the same kind of indexation as Federal workers receive prior to retirement. They do not, in any significant numbers, receive comparable post-retirement benefit increases. In order for there to be pension equity, the Federal retirement programs would have to be subjected to comparable limits, adjusted to account for the post-retirement COLA protection afforded Federal retirees.

But the freeze on the 415 limits, at whatever level, should not be judged solely on a comparative basis. More important are the absolute effects it may have over time. At first, the suggested limits would affect a small minority of current pension participants. Over time as the general level of wages rises the portion of the workforce affected would increase. Freezing the limits would result in their declining over time in real dollar terms and relative to wages. As more and more people would bump up against the limits the income replacement capacity of pensions would be diminished. In combination with the redistributive nature of Social Security this would mean an ever increasing share of the elderly would receive inadequate retirement benefits from organized retirement programs. This would imply a policy goal of the Ways and Means Committee of shrinking the purchasing power of private pension programs. If so, why start with private pensions which now receive a minor share of the Federal largesse?

While high income executives benefit from the 140 percent limits, these limits could well account for the creation of many secondary plans. The beneficial result, however, is that the employers of such executives must also be covered by the secondary plan for it to be tax qualified. There is the clear potential for the elimination of the 140 percent limits to result in some secondary plan terminations. Plan terminations or forgone plan creations could potentially have their full effect about the time Social Security will be buffeted by the baby boom retirement problem. The elimination of the special deferrals for a few high-wage earners may lead to the reduction of valued benefits for many more middle income workers. Is it really the desire of the Ways and Means Committee to reduce the pension benefits of middle-class workers?

On Social Security integration the concern seems to be that employers are taking undue advantage of the redistributive nature of Social Security. The intent, implementation and implications of the integration regulations are probably the most misunderstood aspect of pension policy today. The evidence that is used to assess integration is either old or unrepresentative of the universe of plans. If the concern is that some workers are being integrated out of a pension plan then we should at least know of the prevalence with which it occurs. I might add that even where it does occur the combined pension/Social Security benefit structure of such a plan is still more re-distributive than the Civil Service Retirement System.

EBRI is currently sponsoring a major study of integration which is being conducted by Dr. James Schulz of Brandeis University and President of the Gerontological Society of America. That study will be completed this summer and will be shared with the Congress at that time.

You have heard estimates today that passage of H.R. 6410 could result in reduced benefits for 68 percent of those participating in private pensions. I have not tried to verify those estimates but I do know that plan terminations tripled during the implementation of ERISA and are still running much higher than before ERISA's implementation.

With the problems of Social Security as yet unresolved it may be premature to take major policy steps that could potentially jeopardize the retirement income security of today's workers. This is not to suggest that this legislation is without merit or that new policy initiatives are not appropriate. I merely want to suggest that we need to step back and take a broader look at all elements of the retirement system, private and public, and be sure of the relative roles we want each program to play before making major legislative changes. This is the position that the Administration and Congress have prudently taken with regard to the National Commission on Social Security Reform.

Finally, I want to thank you for allowing me to appear today. In closing, I offer the services of the Employee Benefit Research Institute in assisting you in this study and policy formulation process in whatever way we can.

Chairman ROSTENKOWSKI. Our next witness is Carroll J. Savage.

STATEMENT OF CARROLL J. SAVAGE, ON BEHALF OF THE EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION (ECFC)

Mr. SAVAGE. My name is Carroll Savage, and I am appearing in my capacity as counsel for the Employers Council on Flexible Compensation.

A list of the members of the ECFC is attached to my written statement which has been submitted for the record, which I will summarize.

In 1978 the Congress took a major step toward the expansion of flexible compensation programs by adding to the code section 125 and section 401(k) providing rules for cash or deferred plans and so-called cafeteria plans, which provide choice to employees benefits such as retirement savings, health care, life insurance or additional cash compensation. For a plan to obtain the benefit of these rules, it must not discriminate in favor of officers, shareholders or highly paid employees.

Many companies are in the process of instituting flexible compensation programs for their employees.

Today, even more than in 1978, there is an appreciation of the importance of these developments to the welfare of rank and file employees in broadening needed welfare plan coverage while enhancing the productivity of companies through cost-efficencies and enhancing the concepts and goals of capital accumulations.

The proposals of H.R. 6410 woud have a severe adverse impact on the development of these programs. The ECFC is opposed to the bill for the many reasons pointed out by previous witnesses who have addressed the inadvisability of the proposals affecting limitations, the integration rules, and other important characteristics of the present pension system.

I want to specifically address two aspects of the bill that have not gotten as much attention as some of the other points, undoubtedly because there are so many important things in this bill that people have had to stress certain things because of the time limitations.

The first point I want to bring up is section 7 of the bill, relating to statutory fringe benefit plans. Section 7 would provide an entirely new set of nondiscrimination rules that would standardize the requirements of certain statutory fringe benefits already subject to nondiscrimination standards under the code and would extend these same rules to the more important areas of health care insurance and group term life insurance.

The ECFC would support an orderly legislative approach to standardization of the existing fringe benefits under the code.

Mr. RANGEL. What page are you on?

Mr. SAVAGE. I am summarizing my testimony, Mr. Rangel.

We believe the actual provisions of the bill as now written would be an unmitigated disaster for employees and employers alike. The proposed participation rules are unworkable in that they propose to provide an actual participation standard rather than availability standards for these plans.

Mr. RANGEL. What would be a disaster? I am not following you.

Mr. SAVAGE. The proposed rules on statutory nondiscrimination for health care programs and group term life insurance.

Mr. RANGEL. What would be wrong with that, if you have it for yourself, have it for the rank and file?

Mr. SAVAGE. Everyone does. That is one of the points of my statement, that health care for full-time employees in this country is virtually universal.

Mr. RANGEL. You don't have any problems with the proposed legislation in that?

Mr. SAVAGE. I think it would create a paperwork nightmare that would make ERISA look like child's play.

The cost of administration would actually probably reduce revenues and I think the proposals would serve no useful purpose——

Mr. RANGEL. You agree with the concept, but you can't administrate, it is bad to administer?

Mr. SAVAGE. I think it is—I disagree with it in concept in the sense that it would impose standardization on employers which now have the flexibility to provide employees with what they need, when they need it, rather than having to provide every group of employees throughout the country with a precise type of benefit, many of who do not need it.

Mr. RANGEL. OK.

Mr. SAVAGE. The price that would be paid would be greater adminstrative costs, greater rigidity, poor coverage, and loss of revenues because of the tax deductions.

Mr. RANGEL. Could you tell me some type of fringe benefit that the high paid executive would need and the lower rank and file wouldn't need?

Mr. SAVAGE. Well, certainly.

Take airline pilots who are relatively high paid. There might be very, very sound reasons—many good business reasons why you would want to provide a much better health benefit program for the pilots than for the ground crews.

Mr. RANGEL. Relative to income, but OK.

Mr. SAVAGE. This kind of provision would hamstring every company. You might want to provide a different type of health benefit for mine workers subjected to a lung problem than you would for office employees. This type of——

Mr. RANGEL. If there is anything in this bill that says you have to have the same health program, it will be changed. Don't worry about that. We are just saying equal access to health insurance.

So if that is your problem, if it is there, we will change it.

Mr. SAVAGE. There are quite a few problems with the legislation as written. One of them is that it would subject short and long-term disability plans to a non-pay-related standard of discrimination, so that every worker, no matter what his pay level while he was well, would be limited to a flat dollar amount of benefits when he is sick.

Again, that type of thing would cause an enormous disruption——

Mr. RANGEL. Disability income is not included here.

Mr. SAVAGE. It cetainly appears to be included from the text of the legislation.

Mr. RANGEL. It is not included in the health legislation.

Mr. SAVAGE. Group term life insurance, which is, I think, included, has already got a $50,000 limit on the amount that can be provided tax free. So it is already in a sense regressive in that no higher paid employee, nobody making more than $20,000 could get——

Mr. RANGEL. You understood Mr. Savage, that this legislation has nothing to do with an employer doing whatever he wants to do in terms of benefits or fringe benefits. The only thing we are concerned with is what part of that benefit will be tax free.

Mr. SAVAGE. I am sure your intent——

Mr. RANGEL. Your testimony makes it appear we are not aware that certain employees and certain executives have higher responsibilities, different lifestyles and, therefore, should be compensated for it. It is necessary in order to attract and keep these people with businesses and for them to be productive, that you have to give more to the executive than you give to the janitor. No question about it. The only question that we are wrestling with, with your help, is to what degree should the taxpayers subsidize this.

Mr. SAVAGE. I think that health care, as long as it is provided on a tax free basis, the result of that is that such programs are almost universal to full-time workers. There is a need to extend health care and contain health care costs, and the present system is not extending health care beyond where it is now, because it is already universal.

The people who don't have health care are unemployed, casual workers, the short-term employees who would not be covered by your bill anyway. So what your bill would do is impose paperwork requirements, build a new bureaucracy and not accomplish the extension of these benefits significantly beyond the group that is already covered.

[The prepared statement follows:]

STATEMENT OF CARROLL J. SAVAGE ON BEHALF OF THE EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION (ECFC)

The ECFC is a national nonprofit organization committed to the promotion and improvement of flexible compensation programs. A list of the ECFC membership is attached.

"Flexible compensation" means that employees are offered a variety of benefits and are permitted to select the benefits that they want. Traditional, standardized compensation programs result in wasteful expenditures for benefit coverage that some employees do not need or want while denying employees access to many valuable benefits because such benefits are not needed or desired by most other employees.

Flexible compensation plans are the most cost effective way to provide a sound benefit program to employees. Such plans vastly improve the availability of coverage for a given dollar expenditure. Allowing each employee to elect how the employer's expenditure is to be allocated among a "menu of benefits" guarantees that each benefit dollar echieves the maximum amount of return in terms of employee satisfaction and morale. Accordingly, such programs can be expected to increase productivity. The element of employee choice is also a significant factor in health care cost containment.

In 1978 and 1980 legislation, provisions of the Code now found in section 125 and section 401(k) took major steps toward facilitating the expansion of flexible compensation programs. These sections in essence provide that participants in nondiscriminatory programs which constitute cash or deferred plans or so-called "cafeteria plans" and which provide an individual choice to employees among benefits such as retirement savings, health care, life insurance, etc., or additional cash compensation, will not result in adverse tax consequences for an employee solely by reason of the availability of such choice. In other words, an employee who elects additional cash compensation or taxable benefits will be taxed accordingly, but an employee who elects health or retirement benefits, for example, which are excludable from income under specific Code provisions, will not be taxable on amounts contributed to the program merely because he could have elected cash or other taxable benefits. In order for a plan to obtain the benefit of these rules, it must not discriminate in favor officers, shareholders or highly compensated employees.

Regulations are in the process of development under these flexible compensation provisions of the Code and many companies are in the process of instituting flexible compensation plans for employees. The proposals contained in H.R. 6410 would have a severe adverse impact on the development of these programs. The ECFC is opposed to the Bill not only for that reason, however, but more fundamentally because the concepts in the Bill are new and the economic and social impact of the rules on retirement security, capital accumulation, the Social Security program, employee productivity, health care cost containment, and other critical issues are indeterminate. Finally, the Bill contains numerous technical problems and inequities, would vastly increase paperwork, administrative costs, and regulatory burdens. Since most of the Bill's provisions would have little or no tendency to raise revenues for fiscal 1983, nor for the future except at the possible cost of reduced retirement security, the Bill should not be seriously considered in the climate of the current bugetary crisis.

Our specific comments are as follows:

STATUTORY FRINGE BENEFIT PLANS

The Bill would provide an entirely new set of nondiscrimination rules which would standardize the requirements of certain statutory fringe benefits already subject to nondiscrimination standards and would extend these rules to the much more important areas of health care insurance coverage and group term life insurance coverage. As noted above, flexible compensation programs are already required to be nondiscriminatory under existing law, and the ECFC has no desire whatever to promote discriminatory arrangements. While the ECFC would support an orderly legislative approach to standardization of existing nondiscrimination standards for statutory fringes under the Code, the provisions of the Bill as proposed have not been properly considered and would be an unmitigated disaster for employees and employers alike. The Bill would essentially destroy the development of flexible compensation programs for several reasons:

(1) The proposed participation rules are unworkable in that they impose a requirement not of nondiscriminatory eligibility but rather actual participation which meets certain standards. These rules would be impossible to meet in geographically diverse companies, in areas with several competing HMO's, or in any flexible compensation program providing a meaningful range of choices among medical plans or other fringes. There is no social or revenue justification for hampering the provision of proper coverages by rigid rules of this kind.

(2) The proposed rules on nondiscrimination in benefits also legislate rigidity rather than flexibility in that they require that the same types and amounts of benefits available under the plan to so-called "key employees" be available to all other employees, totally ignoring the enormous diversity in the workforce. A plan which does not discriminate in favor of key employees nevertheless provides an enormous variety of different benefits on the basis of factors unrelated to the employee's status as an officer, shareholder or highly compensated individual. Benefit types and levels vary by geographical area, within different trades or industries, by reason of age, marital status, number of dependents, length of service and numerous other factors. Flexible benefit programs and many traditional benefit programs as well could not survive under these provisions of the Bill.

(3) Disability coverage, unlike health care, has always been provided on a concept of wage replacement. Like life insurance, the amounts of available coverage should not be deemed nondiscriminatory where the levels of such coverage are proportionate to compensation. Companies will not provide meaningful disability coverage to rank-and-file employees if meaningful coverage cannot be granted to highly paid employees. The purpose of disability coverage is to allow an employee to continue something comparable to his former standard of living during the period of disability. These provisions are only one example of the kinds of errors that hasty consideration of these proposals can produce.

(4) Extension of a new set of nondiscrimination rules to health insurance programs is highly undesirable. While broad health care coverage is unquestionably a sound objective, it is probable that such coverage among employees already extends to a larger percentage of the labor force than would be required to be covered under the proposed nondiscrimination rules even if every corporation had a health care plan. In most industries health care coverage is already virtually universal, whereas

the bill would allow for exclusion of employees with less than three years of service, seasonal and part-time employees and collective bargaining units. The proposed legislation would layer a new level of administrative complexity, paperwork and cost increases on an area already overburdened with administrative costs without accomplishing any worthwhile social or budgetary objective or extending medical care coverage in any significant degree to those persons (divorced spouses, unemployed, transient workers, short-term employees, etc.) who comprise most of the group to whom adequate health care coverage is not presently available. Flexible compensation programs which contain health benefits, which will flourish in a proper legislative and regulatory environment, are already governed by statutory nondiscrimination rules. An Appendix is attached which contains a more complete discussion of this subject.

(5) Nondiscrimination standards should not be imposed on group term life insurance programs. Since there is a $50,000 ceiling on the amount of coverage which can be provided tax-free to employees, the tax impact of such programs is already regressive. A program that provides life insurance coverage of 2½ × pay already results in taxable income to participants earning more than $20,000 per year. Nondiscrimination standards which require that benefits be proportional to compensation make no sense where there is a statutory ceiling on benefits at such a low level as now exists in Code section 79, but only increase paperwork and administrative burdens.

LOANS FROM EMPLOYEE PLANS

The ECFC strongly recommends against the provisions of the Bill causing adverse tax consequences for employees in the case of borrowing from certain qualified plans. One type of plan with respect to which borrowing would be prohibited, not merely for highly compensated employees but for all participants, is a cash or deferred arrangement, which may be a key part of any flexible compensation program, Such cash or deferred arrangements are excellent vehicles for capital accumulation and for building retirement security. Participation in these programs is optional with each individual employee. Except in cases of financial hardship, amounts deferred under such a program are unavailable unless the employee separates from service. Employees, particularly the rank-and-file group, will be hesitant to irrevocably commit substantial amounts to a retirement program if they cannot count on the possibility of obtaining temporary use of funds to deal with unforeseeable cash needs which may occur at future points in their careers. Among those who would participate despite removal of loan opportunities, the result could be to encourage instability in employment by forcing a separation from service to obtain temporary use of needed funds. Even if the proposal were construed to allow loans despite their characterization as distributions (by no means clear), the consequences of allowing plan loans under such circumstances would be complex and costly to the participant.

The important thing to stress here is that a plan loan is not like a distribution and therefore should not be treated as such. Under existing Internal Revenue Service and Department of Labor rules, the terms of loans must be determined at arm's-length and loans must bear reasonable rates of interest and be repayable over a reasonable time with adequate security.

Apart from the substantive objections to the loan provisions of the Bill, it should be added that the proposed effective date is unconscionable. Participants have been contributing to plans for years in reliance on the availability of loans in accordance with published government guidelines. Funds would not have been irrevocably committed to these programs in many cases but for this reliance.

SECTION 415 LIMITS AND ESTATE TAX

The ECFC strongly opposes the provisions of the Bill changing the rules concerning limitations on contributions and benefits and imposing limits on the estate tax exclusion. The experience has been that extension of retirement plans to rank-and-file employees and improvement of plan coverage (with the resultant increases in capital accumulation and retirement security) is motivated to no small degree by the provisions of the law which permit a corresponding increase in benefits for management. If this increase in benefits is prohibited, that motivation will be lost and an important inducement to broader and better retirement plan coverage will be lost. The full implications of this are indeterminate, but they could in the long run be devastating to the private pension system, with obvious implications also for the critical subject of Social Security.

SOCIAL SECURITY INTEGRATION

The ECFC opoposes the proposed changes in Social Security integration. The effect of such changes on the relationship between the Social Security system and private retirement system is complex. The proposals appear to be aimed at higher paid employees but may well have the effect of simply reducing defined benefit coverage for all employees.

CONCLUSION

None of the far-reaching and potentially disastrous proposals encompassed in H.R. 6410 has received adequate study. This legislation should not be seriously considered by Congress until a thorough analysis has been made and the implications of the proposals are fully understood.

APPENDIX

The following is a more detailed analysis of the policy considerations in imposing statutory nondiscrimination rules on health insurance programs (Section 7 of H.R. 6410, proposed new Code Section 87).

A. Proposed Code section 87 is misdirected as an incentive for expanded health care coverage.

The only apparent policy objective of Section 7 of H.R. 6410 seems to be an attempt to encourage broader health plan coverage among the employed population by requiring nondiscriminatory plans as a condition for favorable tax treatment for the more highly compensated employees, including management. While expansion of medical coverage is an indisputably worthy goal which the ECFC fully supports, the rules of H.R. 6410 would not operate to further that objective, and in fact would be counterproductive.

Recent studies indicate that while less than 80 percent of the U.S. civilian population is covered by private insurance for hospital care and surgical services,[1] the noncovered population is not the employed population. Recent statistics available from the Bureau of Labor Statistics, for example, indicate that, during 1980, 100 percent of the full-time production, technical and clerical workers in the United States were covered by hospitalization benefits, 100 percent were covered for surgical benefits, and 97 percent were covered for prescription drugs. Other medical coverage ranged from 91 to 98 percent by category of coverage.[2] For professional and administrative employees 100 percent were covered for hospitalization, 100 percent for surgical costs, 97 percent for prescription drugs, and 94 percent for other medical coverage.[3] Two conclusions are apparent from these figures. First, basic medical protection is virtually universal among the employed population. Second, the figures show a negligible difference between production and management workers in the provision for basic health benefits.

A 1979 study by the Congressional Budget Office on health insurance coverage showed that over 80 percent of the uncovered population consists of part-time wage earners, self-employed individuals, unemployed individuals, and others not in the labor force.[4] Furthermore, since over one-fourth of the workers with health care benefits were in plans with waiting periods of three months or longer, a large portion of those few full-time wage earners who are uncovered at any point in time probably will be covered by a health care plan within a short period.[5]

It does not appear that these facts have been considered at all in formulating H.R. 6410. The ECFC believes that Section 7 of the Bill is based on invalid assumptions and that there has been insufficient economic and sociological analysis of its ramifications.

B. The proposed rules would require costly and undesirable standardization of benefits.

At the present time, the varieties of employer-sponsored health care programs and benefits provided are virtually limitless. A large employer which is widely diversified both functionally and geographically may maintain 500 or more different medical benefit programs for its employees nationwide. The health care needs of employees in different areas and industries are so varied as to make it impossible to devise any one standard plan for all of a company's employees. An electronics engineer, for example, has different health concerns and requirements than a machinist, and both have different needs than office workers.

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[1] Marjorie Smith Carroll, "Private Health Insurance Plans for 1976: An Evaluation," Social Security Bulletin, September 1978, pp. 3-16.

[2] Bureau of Labor Statistics, Tables on Benefits in Private Industry, June 26, 1981, Table 2. See also The Conference Board, Profile of Employee Benefits (1981 Edition), pp. 6-18.

[3] Ibid.

[4] U.S. Congressional Budget Office, Profile of Health Care Coverage: The Haves and Have-Nots, 1979, pp. 19-21.

[5] Ibid.

Because of the virtual impossibility of comparing benefits in different programs, employers desiring to assure nontaxable benefits for employees would in most cases be required under the proposal to offer precisely the same benefits to each and every participant. The proposal makes it almost impossible to take into account the varying needs of the employees. Since similar benefits cost different amounts in different localities, true equality would have to be based on a comparison of benefits rather than costs. Even if costs were the same nationwide, however, the proposal would discourage the use of equally costly, yet different, benefits for different groups. A plan today might, for example, cover a group of older, highly compensated management employees and a separate group of younger engineers. Since the needs of the older workers are different than those of the younger engineers, the plan might offer greater dental benefits to an officer or management group. Better maternity benefits, however, may be provided to the engineers. An employer should not be required to extend dental benefits to younger groups instead of improved maternity coverage merely because the older employees are more highly compensated, but uncertainties concerning discrimination will produce such results.

In addition to undermining the employer's efforts to best fulfill employee needs, proposed Code section 87 would often prevent an employer from taking into account the employer's own needs. An employer may provide different benefits to employees within certain job classifications for perfectly valid business reasons. An obvious example of such a distinction is the case of highly compensated airline pilots or other employees in high risk jobs where physical fitness is of paramount importance. An employer may well want to provide superior preventative care to these employees because of the nature of their jobs, a valid employer policy which under the proposal will be impossible to implement without adverse consequences for the employee who is forced into such coverage.

In summary, the size of the employee group, the demographics of the group, the geographical location of the group and numerous other factors influence the design of employer-sponsored health care plans. The factors which must be taken into account in determining the health care needs of a diverse population of employees cannot be reduced to a common denominator without adding needless expense to a health care system already in desperate need of cost containment.

C. *The proposed rules would significantly increase the paperwork and administrative burden.*

One of the important contributing factors in the wide coverage of medical plans is that employers have not been encumbered with substantial and burdensome federal government restrictions on the operation of these plans. The proposed rules would create nightmarish complexity in administration.

As noted above, a company may maintain many hundreds of different health benefit programs for employees throughout the United States. Companies will of course want to assure employees that the health benefits continue to be nontaxable. Although no advance rulings from the Service are required under H.R. 6410, the potential tax impact on employees suggests that it would have become standard operating procedure for companies to apply to the Internal Revenue Service for advance rulings. If the determination letter process for pension plans is any measure, the costs and time involved in applying for such advance determinations would be enormous. Unlike pension and profit sharing plans, furthermore, medical plans are in a constant state of flux. At one member company, for example, an average of more than 100 changes, generally in the nature of benefit improvements, are made to the medical programs in any given year. If, as we expect, this company would feel it necessary to apply for an advance ruling each time that benefits for so-called "key employees" are changed, the company would be filing scores of ruling requests each year. Since most plan changes are benefit improvements based on current perceptions of shifting employee needs, the ruling process would merely impede the implementation of improvements in an area where timing and flexibility are of utmost concern to the covered group.

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Mr. **RANGEL**. I apologize for interrupting your testimony.

Mr. Abbott, have you testified?

STATEMENT OF PAUL H. ABBOTT, JR., VICE PRESIDENT, NATIONAL ASSOCIATION OF PENSION CONSULTANTS AND ADMINISTRATORS, INC.

Mr. **ABBOTT**. I am Paul Abbott, Jr., from NAPCA and also president of the Paul Abbott Co., consulting actuaries of McLean, Va. We have approximately 125 clients. NAPCA has over 300 members who are professional consultants and administrators and are serving over 200,000 small plans.

NAPCA will give primary emphasis today to two aspects of H.R. 6410.

First, we will show that there are substantial legislative history and good economic and tax policy reasons for treating corporations differently from self-employed individuals and partnerships for tax purposes, contrary to sections 5 and 6 of the bill.

Second, that Congress should not make major changes in the private pension system as provided by sections 2, 3, 4 and 8 of the bill unless they are certain what changes will be made in the social security system. As an incorporated professional, I strongly object to the blatant discrimination of H.R. 6410 in singling out personal service corporations and professional corporations for special and unusually harsh treatment under the pension laws. Since the late 1960's, the highest courts in the land have consistently and universally decreed that professionals shall have the right to incorporate as all other businesses. Previous attempts in the Congress to single out personal service corporations for discriminatory tax treatment, have been soundly defeated.

In 1969, a Senate bill similar to H.R. 6410, was defeated by a vote of 65 to 25. In 1973, in discussions leading to the passage of ERISA, another similar Senate bill which attempted to place H.R. 10 limits on professional corporations was defeated by a vote of 89 to 2. More recently, neither the report of the President's Commission on Pension Policy nor the ERISA simplification bill, H.R. 4330, now pending, make any reference to creating a second and substandard class of corporate retirement plans.

There is no substantial difference between the income of a professional as defined in section 6 of the bill and any other corporate income derived from personal services.

However, H.R. 6410 would require that professional corporations be treated differently for pension plan purposes. If anything, professionals who may not make use of the new incentive stock option plans are even more dependent on their private pension plans for retirement security than other corporate employees.

Should Congress decide that pension reform is needed, the proposed changes should affect all corporations, regardless of size or service rendered, with no one group being singled out for special substandard treatment.

To so obviously discriminate against a particular group under the heading of the Pension Equity Act of 1982, would result in a grave act of discrimination against small corporations by the Congress.

No matter how justified, we realize in these difficult times it may be impossible for the Congress to increase the deduction limits for self-employed again from $15,000 to $30,000 due to the unusually high deficit which exists in the Federal budget.

However, in our view, today's private pension system is working well.

Thus the self-employed, if they desire to improve the deductible limits for their qualified plans under the Internal Revenue Code, have the option to incorporate their businesses as taxable entities and then assume all of the attendant obligations and burdens which that action entails with respect to increased social security payments as well as the increased cost of retirement benefits for a less highly paid rank and file employee which the corporate plan must provide if they are to cover the high paid employees at the maximum section 415 limits.

Since the creation of social security in 1935, our national retirement policy has been based on the concept that retirement security is a joint obligation of the individual, his or her employer, and the Federal Government. This concept of a three-legged stool, has long been understood and accepted by employee plan professionals, with a corollary that the primary responsibility for retirement security lies with the private sector and that the Government can and should provide only a minimum level of income replacement at normal retirement.

Gentlemen, NAPCA submits that H.R. 6410 will have a disastrous affect on the private pension system by causing the termination of many thousands of small plans because of the radical changes it envisions.

Therefore, if H.R. 6410 reduces contributions to private plans or causes the termination of any signficiant number of private plans, every taxpayer will ultimately be burdened by additional taxes for primary social security coverage which will be increased in the years just ahead in order to compensate for the reduction in private pensions required to provide a realistic minimum retirement benefit.

We strongly support the traditional concept of a strong three-legged stool, social security as a base, plus private employer-sponsored plans and individual savings.

Thus, NAPCA supports realistic limits on further social security increases and supports economic incentives to encourage the adoption and expansion of private retirement plans and to encourage employee and individual savings for retirement.

It is totally inconsistent to urge reduction of section 415 limits and elimination of the cost of living provisions until Congress first determines what changes will be made in the social security retirement system.

Please don't cut the private pension leg so short that it is impossible to fashion a workable three-legged stool to undergird the national retirement system in the future.

[The prepared statement follows:]

STATEMENT OF PAUL H. ABBOTT, JR., VICE PRESIDENT, NATIONAL ASSOCIATION OF PENSION CONSULTANTS AND ADMINISTRATORS, INC. (NAPCA)

Good morning, Mr Chairman and Members of the Committee. I am Paul H. Abbott, Jr., Vice President of The National Association of Pension Consultants and Administrators, Inc. (NAPCA). NAPCA will give primary emphasis today to only two aspects of H.R. 6410. First, we will show that there are substantial legislative history and good economic and tax policy reasons for treating corporations differently from individuals and partnerships for tax purposes, contrary to Sections 5 and 6 of the bill. Secondly, that Congress should not make major changes in the Private Pension System as envisioned by Sections 2, 3, 4 and 8 of the bill until it is certain what changes will be made in the Social Security System.

I.

NAPCA would like to emphasize to the Committee that the legislative history beginning in the late 1950s shows that there is a clear rationale for the distinction in tax treatment between corporations on the one hand and individuals and partnerships on the other, and that the economic and tax policy reasons behind these distinctions have been carefully preserved in the legislative history.

There is a substantial amount of legislative history to justify the distinction between the tax treatment afforded to retirement plans established for self-employed individuals as opposed to retirement plans established for the benefit of employees of a corporation.[1]

Although HR-10 was a first step toward removing the prevailing inequities, after HR-10 substantial discrimination still existed between plans adopted by the self-employed on the one hand, and those adopted by corporations on the other.[2] As a result, there was an increasing trend toward incorporation by those small businesses which could incorporate. The early 1960s saw extensive legislative actions to permit professionals to incorporate.[3] In extensive litigation with the Internal Revenue Service over the legitimacy of professional corporations and their qualified plans, the Service lost its battle in the courts, and efforts were renewed in the Congress to eliminate by legislation tax discrimination between large business and small business in the area of qualified plans.

In the Tax Reform Act of 1969, taxation of employee plan benefits was modified, and the HR-10 limitations were imposed on contributions to qualified plans adopted by Subchapter S corporations. During consideration of the 1969 Act there was an attempt by certain members of the United States Senate to impose the HR-10 limitations on plans adopted by small corporations.[4] This attempt was soundly defeated by Senate Amendment No. 296 to HR 13270 (The Tax Reform Act of 1969) by a vote of 65-25.[5]

Therefore, the trend toward incorporation of small businesses, particularly professional service corporations, and the adoption of qualified plans for employees of such businesses continued at a rapid pace.

The next major development in the tax laws governing employee retirement plans was the enactment of the Employee Retirement Income Security Act of 1974

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[1] Rapp, "The Quest for Tax Equality for Private Pension Plans: A Short History of the Jenkins-Keogh Bill", 14 Tax L. Rev. 55, 61 (1959); also, 108 Cong. Rec. 18801 (1962).

[2] Taylor, "Retirement Security Planning for the Self-Employed", 75 Case & Comment 42 (Sept.-Oct., 1979).

[3] McKee, Nelson and Whitmore, Federal Taxation of Partnerships and Partners, 3-39 (1977).

[4] Section 901 of Tax Reform Act of 1969 as reported by the Senate Finance Committee. See 115 Cong. Rec. No. 204 at S. 16241-S. 16250 (91st Cong., 1st Sess., Dec. 9, 1969).

[5] 115 Cong. Rec. No. 204 at S. 16250 (91st Cong., 1st Sess., Dec. 9, 1969).

(ERISA). For small corporations, perhaps the most important development of ERISA was an overwhelming confirmation of the principle that tax discrimination between large corporations and small corporations in the area of qualified retirement plans would not be tolerated by the Congress.

This confirmation occurred in 1973, when during consideration of ERISA, a second attempt was made to impose Keogh limitations on qualified plans established for the employees of small corporations. The attempt was defeated by a vote of 89-2 in the United States Senate, thus establishing once and for all the principle of tax equality between large corporations and small corporations, including professional corporations.[6]

It is also important to note that, in proposing the $7,500 (now $15,000) limitation on employer contributions to "Simplified Employee Pensions," [7] the Congress was careful in The Revenue Act of 1978 to note that:

> The special limits applicable to contributions under simplified employee pensions are not intended as a precedent for establishing reduced limitations on contributions for employees under qualified plans of small business employers or other employers.[8]

It is clear from the foregoing discussion that the legislative history clearly supports a rationale for the distinction between corporate and noncorporate qualified retirement plans but not between plans of large corporations and small corporations or between corporations engaged in different businesses, whether professional or otherwise. Congress has in the past maintained this entity distinction for tax purposes and has only treated one type of corporation, the Subchapter "S" corporation, differently due to the fact that it is not taxed as an entity but is merely a conduit for tax purposes similar to a partnership. Legislation is pending in the Congress which would make Subchapter S corporations indentical to partnerships.

Corporations have, since the days of the early English Common Law, been recognized as distinct and separate entities, and this treatment has become ingrained in our tax laws. The legislative history provides a clear rationale for the distinction between those who incorporate their businesses and those who do not, and the tax policy behind the distinction is based on the legislative battles which have been fought over the years to gain tax parity for the employees of all corporations, be they large or small.

CONCLUSION

Thus, in 1969 and again in 1973 the proponents of parity for the self-employed have urged that sole proprietors and partners be treated the same for qualified retirement plans purposes as corporations. They care not whether the Congress penalizes small corporations in order to achieve this purpose. They say they intend for all professionals to have the same retirement benefits which they urge the Congress to set at $30,000. However, in these difficult times it is impossible for the Congress to increase the deduction limits for the self-employed again from $15,000 to $30,000 due to the unusually high deficit which exists in the federal budget. In our view the private pension system is now working well! Participants in HR-10 have just received an increase in the maximum deductible limits from $7,500 to $15,000, effective January 1, 1982. Corporate retirement plans have received no increase except that which was provided by the Cost of Living provisions (COLA) under Section 415 of the Internal Revenue Code.

Thus, the time has come once again for Congress to inform the self-employed that if they desire to improve the deductible limits for their qualified plans under the Internal Revenue Code, they have the option to incorporate their businesses as taxable entities and then assume all of the attendant obligations and burdens which that action entails with respect to the increased Social Security payments by the employer and employee as well as the increased cost of retirement benefits for their less highly paid rank and file employees which corporate plans must provide in order to cover the highly paid employees at the maximum levels provided in Section 415 of the Code.

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[6] 119 Cong. Rec. No. 136 at S. 16879 (93d Cong. 1st Sess., Sept. 19, 1973). A "proprietary employee" was defined as one who owned at least two percent (2 percent) of the stock of a corporation and who when combined with all such other "proprietary employees" owned twenty-five percent (25 percent) or more of the benefits provided under a qualified retirement plan. 119 Cong. Rec. 136 at S. 16879 (93d Cong., 1st Sess., Sept. 19, 1973). S. 1179 as reported in 1973 by the Senate Committees on Finance and Labor and Public Welfare contained a provision essentially placing the HR-10 limitations on retirement plans benefiting "proprietary employees". The Thurmond-Nelson compromise Amendment No. 506 which deleted the "proprietary employee" provisions and imposed the existing Section 415 limitations on corporate plans was carefully hammered out between representatives of the Joint Committee Staff and representatives of small business and was adopted by the Senate by a vote of 89-2.

[7] Section 152, Revenue Act of 1978

[8] General Explanation of the revenue Act of 1978, Joint Committee on Taxation (March 12, 1979).

Congress should not make changes in the Section 415 limitations, the COLA provision under Section 415, and the integration of private retirement plans with Social Security until we know what changes will be made in the Social Security Retirement System.

Since the creation of Social Security in 1935 our Nation's retirement policy has been based on the concept that retirement security is a joint obligation of the individual, his or her employer, and the federal government. This concept of the "three legged stool" has long been understood and accepted by employee plan professionals, with the corollary that the primary responsibility for retirement security lies with the private sector, and that government can and should provide only a minimum level of income replacement at normal retirement. In recent years, this understanding has eroded among members of the general public. A recent Louis Harris Study, sponsored by Johnson & Higgins, (the Study),[9] confirms this change in public attitude. Reasons for the currently prevailing attitude are debatable, although in our judgment national policies of central planning, wealth redistribution, and massive government regulation, coupled with severe inflation, are undoubtedly major causative factors.

The study further indicates that the single retirement issue of greatest concern to the American people is whether pension benefits will keep up with inflation! Most of those individuals responding to the Study indicated that they would be willing to increase their contributions to retirement plans in return for increased benefits that would keep pace with the cost of living. Furthermore, the Study indicates substantial support for tax incentives for employee contributions to private pension plans. A good step was taken by the Congress in the Economic Recovery Tax Act of 1981 by providing for deductibility of voluntary employee contributions up to $2,000 per year and $2,250 where there is a nonworking spouse.[10]

The findings of the Study are critical because they clearly demonstrate that the fundamental principle underlying the national retirement policy is not fully understood by many average Americans. At the same time, the findings demonstrate that certain obvious steps, which would strengthen the private "leg" of the "three-legged stool," have strong public support.[11]

We believe that a major objective of changes in private retirement plan policy should be to capitalize on public attitudes and to enact additional economic incentives to encourage the establishment of new employee benefit plans and the improvement of existing plans. in light of this attitude, why destroy the COLA provisions in section 415—the very thing your constituents want most? In any event, don't eliminate COLA in private plans unless you also plan to eliminate it in Social Security as well. The public should know exactly what is expected of it, and employers and individuals should be permitted and, indeed, encouraged, to take actions to meet that expectation through properly designed employer-sponsored plans and individual savings for retirement.

Before addressing specific methods for providing the additional economic incentives, including various legislative proposals now pending in the Congress, we would like to offer a few general comments in support of the concept of encouraging savings through encouraging the creation of employee retirement plans and the making of employee contributions to such plans.

At the present time, most large businesses and large employee organizations have comprehensive employee benefit plans, including retirement plans. This is not the case with respect to small businesses, and the greatest opportunity for expansion of private pension coverage clearly lies in the small business area. To the extent the private sector is permitted to provide for adequate retirement, future demands on the Federal Government—Social Security in particular—will be lessened. For this reason, if for no other, it appears to NAPCA to be consistent with the fight against inflation—and with the fight for retirement security—for the private retirement sector to be permitted, and indeed encouraged, to expand and flourish. In H.R. 6410, you are about to "kill the goose that laid the golden egg" and impose much additional responsibility for retirement of the employees of small businesses back onto the public system which can ill afford any additional burden at this time.

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[9] *1979 Study of American Attitudes Toward Pensions and Retirement*, Commissioned by Johnson & Higgins, Conducted by Louis Harris and Associates, Inc. (February, 1979).

[10] IRC §§ 219(b)(1) and 219(c)(2).

[11] See generally "Retirement Policy, 'Three-Legged Stool' Discussed at Meeting of President's Commission on Pension Policy", 260 BNA Pension Reporter A-8 (October 8, 1979); Speech by Rep. John N. Erlenborn to the American Bankers Association discussed in BNA Daily Tax Report G-4 (November 6, 1979).

Consider the effect of Title IV of ERISA and The Multiemployer Pension Plan Amendment Act of 1980 on new or improved defined benefit plans. What employer wants to assume the burdens for the employees of every unsuccessful business in the country?

Gentlemen, NAPCA submits that H.R. 6410 will have a disasterous affect on the Private Pension System by causing the termination of many thousands of small employee benefit plans because of the proposed cutback in the Section 415 annual addition limitations. Therefore, if H.R. 6410 reduces contributions to private plans or causes the termination of any significant number of private plans, every taxpayer will ultimately be burdened by additional taxes for primary Social Security coverage which will be increase in the years just ahead in order to compensate for the reduction in private pensions required to provide a realistic minimum retirement benefit.

We do not believe it is feasible to continue trends of ever-increasing Social Security benefits. Such trends simply address the symptoms of inflation on a short term basis while ignoring the cause of inflation. Ultimately, increased benefits must be paid for, and we sincerely question not only the willingness, but the very ability, of the American people to continue to pay more and more taxes for Social Security.

We strongly support the traditional concept of "the strong three-legged stool," i.e., Social Security as a base, plus private employer-sponsored plans, and individual savings. Thus, NAPCA favors realistic limits on further Social Security increases and supports economic incentives to encourage the adoption and expansion of private retirement plans and to encourage employee and individual savings for retirement.

CONCLUSION

It is totally inconsistent to urge the reduction of the Section 415 limitations and the elimination of the Cost of Living feature of Section 415 and to change the method of integrating plans with Social Security until Congress first determines what changes will be made in the Social Security Retirement System.

Please don't cut the "Private Pension Leg" so short that it is impossible to fashion a workable "three-legged stool" to undergird the national retirement system in the future.

Mr. **Rangel.** You know there is nothing in this bill that requires any employer to cut down the benefits of the rank and file. Basically what you are saying is that once you start capping the higher income people, they will not find these pension plans to be cost-effective and will terminate the plans. That is what you are suggesting isn't is?

Mr. **Abbott.** What I am suggesting, Congressman Rangel, is that I think there are two factors involved here. One is the actual effect of the major modifications which this bill suggests, and we are not talking about any one area, but the change in maximum limits, and perhaps not quite as a major change there, but that is the first aspect that employers will ask themselves again, as they did with ERISA. Do I want to continue to have a pension plan when every 6 or 8 years the Federal Government is going to come along and say that what they said was legitimate 6 or 8 years ago is no longer legitimate.

Mr. **Rangel.** When you sell them these plans, you try to show them where they can save their money and have it, too?

Mr. **Abbott.** I think that's—if I can, I think that is a misrepresentation.

Mr. **Rangel.** You try to allow them to receive the maximum benefits with the lowest possible cost, deferring tax on the maximum amount of income. There is nothing wrong with that.

Mr. **Abbott.** I would agree there is nothing wrong. What we try to do is establish plans for clients where we design a plan that meets the client's objectives. They are generally defined in terms of the amount of contribution they can afford to make or the benefit levels he would like to establish.

Mr. **Rangel**. For himself.

Mr. **Abbott**. To the extent that he can no longer establish the benefit level which he would like or that he feels the Federal Government is impinging upon his rights as he understood them; then I think he is in some cases, whether it was economic or not, going to terminate his plan.

Mr. **Rangel**. When we talk about rights, we also talk about privileges. You pay taxes on income and then the Congress has accepted as national policy that on certain income, you defer taxes for pension benefits. So it is not a right, it is a privilege where we want to encourage people to save money for their pension.

My problem is that the formulas that we have been using as relates to the rank and file, appear to have been inequitable. You are saying whether they are inequitable or not, to change those formulas would be more costly. Then the entrepreneurs, the prime beneficiaries of these tax laws, would decide that the tax shelter and tax deferral is not that important and would wipe out the plan. I have a problem with that. That is where I will continue to support an inequitable plan. Where the real benefits are accrued to a different group of people and the people that receive these benefits are the people that you are selling the plan to.

I do have a problem. This committee needs sorely to see examples where the rank and file are going to be hurt. We need examples that are not from the sellers of the plans, because the seller of the plan has to keep the costs down. You keep the costs down by keeping the benefits down to everyone except the one that is paying for the plan.

It seems that way to me.

Mr. **Abbott**. On the contrary, most plans where the benefit provisions are at the 415 limits today, it is impossible to take a grade out for everyone. All of my clients who have benefits that are at the $136,000 level are providing substantial benefits for their rank and file employees, because that is the requirement of the law. And there is——

Mr. **Rangel**. Well, I am going to——

Mr. **Abbott**. I think we could debate forever what is inequitable. The truth of the matter is that the rank and file employee under those plans is getting much more than he would get if the limit were $90,000 or $60,000 or whatever, because there is always—pension plans are salary-based and there is always going to be a larger benefit for the higher paid person. I don't think that if you look carefully that you will find as large an inequity as you seem to find today.

Mr. **Rangel**. I am going to exercise the prerogative to place in the record cases where inequities exist and excerpts from pension plans where the providers indicate the benefits can be kept to minimum or no benefit for the rank and file with maximum benefit for the purchasers. This doesn't mean that everyone is doing it, it just means that we should be able to get a little more protection.

Miss Reuss?

Mr. **Fowler**. Will the gentleman yield?

Mr. Abbott, that last point, I want to explain my naivete, because I do not understand this. You are saying that if we change the tax deferred, therefore, tax subsided limits from $138,000 down to $90,000 or whatever, that that is going to cause us, in your opinion, a lot of mortalities of plans. These people, to abandon, you say they will abandon these programs. Help me with my naivete. The fact that I get $90,000 tax deferred, basically tax free rather than $136,000, seems to me I am still—I would still love to have that $90,000. Why is that going to make me quit that?

Mr. ABBOTT. The only change in H.R.—the only change in pension laws under H.R. 6410 would change the maximum limits from $136,000 to $90,000. I would have to be honest in telling you that you have relatively fewer terminations than you would if the entire bill was passed.

Mr. FOWLER. What is the trigger?

Mr. ABBOTT. I think you have a grave, some taxpayers would call infringement. You have—right now there is no question that the law provides that you can have a benefit of $136,425 and then you can reduce that to $90,000 if something has been taken away. That has a psychological impact. I am not suggesting nor do I personally feel that I, if it were affecting me that way, that I would terminate a plan solely because of that, but I have known employers to terminate plans for less value. I think that regardless, if we add to that, the cost-of-living factor, you have an employer who is my age, and working until age 65, 16 years away, he applies any reasonable discount to the value of that $90,000 benefit, he may deduce that you took away more than just $46,425, you have taken away his subsidy for him.

Then you say he is going to have no more time at 55 and now he has to go to 65, whether we are talking—the 90 comes down to something less than that at 55 where he had 136, just saying if you add all of those together, you come up with a pittance of evidence that you know, the grade will be impacted and the biggest problem, I think the committee has to solve and, as I said in my remarks I have no objection to pension reform, if the committee feels there should be pension reform, it should affect all corporations, but I think that you have to be awfully careful in understanding when the Congress takes some action, they send signals to the country. Whether those signals are read properly or not I don't know, but I know ERISA caused a tremendous disruption not by its terms, but because of the fact that there was substantive change. We are talking here about a bill that would impose substantive change on the pensions of this country. Two things would happen. There will be massive termination——

Mr. FOWLER. But you can't tell me why?

Mr. ABBOTT. Yes, I said for several economic reasons because employers can no longer provide the benefits which they want to provide for themselves and psychologically because they felt that once again the Federal Government is imposing upon them more regulations which this administration, at least, has said they are opposed to.

Mr. FOWLER. I have been sitting here uncharacteristically quiet because I don't know anything about this area, but just for you and all the people that have been here, you all come in the last reel of the movie with talk about the three legged stool and everything that is going to happen, because last year we sat through all this, hearings about signals and pensions, psychological results of our actions, and all of your professional colleagues saying we won't ask for tax-deferred shelters if we knew the Congress would just bring down the maximum rate taxation from 75 to 50 percent.

So we did that. You said, Oh, we won't need half the tax-deferred shelters if you would give us an expansion of IRA's, all these people that would like to save would have an incentive to save, so we did that. And on and on, of all the benefits besides a reduction of 5 to 10 percent in the income tax across the board, we did all those things, but now the few hearings that we have had on any proposals, as the chairman said, just to simply address the public policy issue now as to what we ought to be subsidizing in times of high deficit, when we have given him encouragements last year in the President's tax cut, ERTA, or whatever it is called, for people to save and people not to have to find every sort of shelter and purchase every sort of shelter in order not to pay too much tax, you are coming back with the same arguments.

I hear the same arguments. They never stop. I just cannot believe that anybody is going to make the argument that what is a level, a permissive level that the Congress has enacted in the past for possibly the best public policy reasons, say it is $136,000 ought not to be reviewed in light of all these other changes in the tax code, which causes that type executive that you are trying to defend to be in lower brackets anyway.

And it just—you know, we never get out of that trap of always trying to keep what you have even after you have gotten what you have asked for in other parts of the tax cut. That ends my speech, not much of one, but you just have to talk once a year. We have to listen every day, and it is tough when so much is given and then you come back and much more is required.

Mr. RANGEL. Let's hear from the Women's Equity Action League.

Mr. FOWLER. Unless Mr. Savage wants to answer.

Mr. SAVAGE. The tax reduction from 70 to 50 percent did not help the executive that we are talking about. He was already at 50 percent. He got no tax reduction as a result of that. So the beginning here would be to actually increase his taxes——

Mr. FOWLER. You are setting some of them at 70 percent.

Mr. SAVAGE. Earned income was taxed at 50 percent even before the tax bills.

Mr. FOWLER. You are not going to make the argument that reducing that maximum rate on unearned income is not of substantial benefit to your executives? You wouldn't be in all these shelters?

Mr. SAVAGE. We are suggesting that most of these people who are benefitting from these pension plans probably do not have any significant amount of earned income. I can't document that with statistics today.

Mr. RANGEL. We want to hear from the Women's Equity Action League.

Mr. FOWLER. You must be on the chairman's side, so go ahead.

STATEMENT OF PATRICIA BLAU REUSS, LEGISLATIVE DIRECTOR, WOMEN'S EQUITY ACTION LEAGUE

Ms. REUSS. Mr. Chairman, and members of the committee, my name is Patricia Reuss. I am legislative director of the Women's Equity Action League, known as WEAL. Founded in 1968, WEAL is a national membership organization dedicated to securing and protecting economic, legal, and educational rights for women. I am testifying before this committee today in support of H.R. 6410, the Pension Equity Tax Act of 1982. WEAL believes that the policies embodied in H.R. 6410 would result in the provision of more equitable pension plans for all workers, and especially those who are low-wage or low-tenured participants in the labor force, and that means women.

Before specifically addressing this section, I would like to provide a brief summary of the overall pension situation for women who are employed in the private sector since such a discussion is germane to the topic of pension integration practices.

According to a survey covering private industry employment in 1979, about 50 percent or 30 million full-time workers were covered by private retirement plans. The coverage rate for full-time men was 55 percent compared with a coverage rate of 40 percent for full-time women, and indeed, the rate for all women drops to 31 percent when part-time workers are included.

Why is a smaller proportion of women workers covered by private pension plans? A Social Security Administration analysis concludes:

Part-time workers are less likely to be covered; 30 percent of all women workers in 1979 were part-time compared to 11 percent of all male workers;

Most workers under age 25 are not eligible to participate in pension plans; about 25 percent of working women are between the ages of 16 and 25;

Union members are more likely to be covered than nonunion members; only 14 percent of women workers were union members in 1979 compared with 30 percent of the male workforce;

Small, nonunion retail and service industry establishments provide poor if any coverage; 4 out of every 10 women in 1979 were employed in these types of businesses;

Pension coverage is closely correlated with earnings; only 10 percent of workers with annual wages of $5,000 were covered in 1979 while almost 80 percent of workers with incomes of $15,000 or more were covered. The median annual earnings for women covered by retirement plans in 1979 was $10,500 compared with $17,400 for men.

The scenario for women deteriorates further when one examines their actual participation in employer pension plans. Of the 22 million private sector full-time women workers recently surveyed, about 9 million were covered, but less than one-half had attained vested status. This means only 15 percent of women working full-time outside the home in the private sector had acquired the right to participate in and eventually retire on the benefits of a private pension plan.

I don't think those women that do not vest would argue over the amount. They have no pensions and that is why we are here today. A major reason that so few women are vested is based on their low-job tenure rates. Many leave the job market to have families just at the age when pension participation begins. Most women are rank and file employees with unique and intermittent working patterns, including high-job turnover.

The average life of a full-time working woman on one job is under 3 years, hard to vest, hard to acquire any sort of participation or coverage under any pension system. Even if the private pension coverage were universally available, women would still have difficulty fulfilling the requirements for vesting and eventually collecting.

In addition, the current rules related to the integration of social security benefits in private pension benefit formulas further reduce the proportion of low-income workers—read women—who actually receive retirement benefits from private employer plans since many of these employer-sponsored programs under IRS offset provisions pay no benefits to low-income workers or to workers with short tenures.

One of the major principles used in determining social security OASDI benefits has been to provide greater income replacement of preretirement earnings to low-wage earners than high-wage earners. In conjunction with this social security policy, the original and well-intended design of integration as a tax policy was to prevent pension plans from discriminating in favor of highly compensated employees and to insure that lower income people also benefited from these tax breaks. In fact, the current nondiscrimination rules in pensions encourage rather than prevent discrimination in favor of the highly paid.

For those plans that are integrated to a significant degree with social security, the result is that lower income individuals receive little or no company benefits. Although data pertaining specifically to women's participation in integrated plans is not readily available, it appears that many women do participate in integrated plans since surveys indicate that the majority of plans are integrated, that small plans are more likely to be integrated, and that nonunion plans are more likely to be integrated. Less integrated benefit formulas produce higher earnings replacement rates particularly for low-wage earners. Based on this analysis, WEAL supports the proposal presented under section 4 of H.R. 6410.

WEAL is concerned about current social security integration practices because they exclude many women workers from participating in pensions and collecting retirement benefits above the pitifully inadequate social security OASDI benefits. We feel that this legislation, as well as other badly needed pension reforms, is necessary to improve the economic status of retiring women workers.

WEAL commends the committee for holding these hearings and giving serious consideration to the provisions included in H.R. 6410 that would provide more equitable treatment of rank and file employees. WEAL plans to present a more detailed statement concerning section 4 as well as other sections of this legislation in writing to the committee by June 18, 1982.

Thank you for allowing me to present this testimony today and thank you for supporting H.R. 6410 and pension equity.

For most women, two legs of the three-legged stool are completely missing; and therefore I submit that for most of the women who live alone, almost 7 million women over the age of 65, their entire retirement income is social security, and that is a tough balancing act. So I thank you for your concern especially for those people and WEAL pledges to work with the private sector, private employers, actuaries, analysts, consultants, so we can insure that the rank and file, regardless of the shelters offered to the higher income employers, can begin building the third leg on that stool.

Women who work all their lives need private pension benefits, and so if you have continued or further hearings, we will be back to discuss it with you. Thank you.

[The prepared statements follow:]

Statement of Patricia Blau Reuss, Legislative Director, Women's Equity Action League (WEAL)

Congressman Rostenkowski, members of the committee, I am Patricia Blau Reuss and I appear before you representing the views of the Women's Equity Action League, known as WEAL. Founded in 1968, WEAL is a national membership organization dedicated to securing and protecting economic, legal and educational rights for women. I am testifying before this committee today in support of H.R. 6410, the "Pension Equity Act of 1982." WEAL believes that the policies embodied in H.R. 6410 would result in the provision of more equitable pension plans for all workers, and especially those who are low-wage or low-tenured participants in the labor force . . . and that means women.

Before specifically addressing section 4 of H.R. 6410, which would revise the social security integration rules, I would like to first provide a brief summary of the overall pension situation for women who are employed in the private sector since such a discussion is germane to the topic of pension integration practices.

WOMEN AND PRIVATE PENSIONS

According to a survey convering private industry employment in 1979, about 50 percent or 30 million full-time workers were covered by private retirement plans.[1] The coverage rate for full-time men was 55 percent compared with a coverage rate of 40 percent for full-time women. (The rate for all women drops to 31 percent when part-time workers are included.) Why is a smaller proportion of women workers covered by private pension plans? A Social Security Administration analysis concludes:

Part-time workers are less likely to be covered—30 percent of all women workers in 1979 were part-time compared to 11 percent of all male workers;

Most workers under age 25 are not eligible to participate in pension plans—about 25 percent of working women between the ages of 16 and 25;

Union members are more likely to be covered than non-union members—only 14 percent of women workers were union members in 1979 compared with 30 percent of the male workforce;

Small non-union retail and service industry establishments provide poor if any coverage—4 out of every 10 women in 1979 were employed in these types of businesses:

Pension coverage is closely correlated with earnings—only 10 percent of workers with annual wages of $5,000 were covered in 1979 while 70–80 percent of workers with incomes of $15,000 or more were covered. The median annual earnings for women covered by retirement plans in 1979 was $10,500 compared with $17,400 for men.

The scenario for women deteriorates further when one examines their actual participation in employer pension plans, of the 22 million private sector full-time women workers surveyed by the Social Security Administration, about 9 million were covered, but less than one-half had attained vested status (i.e., the right to benefits upon retirement based on number of years of "covered" employment.)[2] This means only 15 percent of women working full-time outside the home in the private sector had acquired the right to participate in and eventually retire on the benefits of a private pension plan.

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[1] Beller, Daniel J., Coverage Patterns of Full-time Employees Under Private Retirement Plans," Social Security Bulletin (July 1981).

A major reason that so few women are "vested" is based on their low job tenure rates. Many leave the job market to have families just at the age when pension participation begins. Most women are rank and file employees with unique and intermittent working patterns, including high job turnover. Even if private pension coverage were universally available, women would still have difficulty fulfilling the requirements for vesting and eventually collecting.

In addition, the current rules related to the integration of social security benefits in private pension benefit formulas further reduce the proportion of low income workers (read women) who actually receive retirement benefits from private employer plans since many of these employer-sponsored programs under IRS offset provisions pay no benefits to low income workers or to workers with short tenures.

INTEGRATION AND HOW IT AFFECTS WOMEN

One of the major principles used in determining social security OASDI benefits has been to provide greater income replacement of preretirement earnings to low-wage earners than high-wage earners. In conjunction with this social security policy, the original and well-intended design of integration as a tax policy was to prevent pension plans from discriminating in favor of highly compensated employees and to ensure that lower income people also benefited from these tax breaks.[3] In fact, the current nondiscrimination rules in pensions encourage rather than prevent discrimination in favor of the highly paid.

For those plans that are integrated to a significant degree with social security, the result is that lower income individuals receive little or no company benefits. Although data pertaining specifically to women's participation in integrated plans is not readily available, it appears that many women do participate in integrated plans since surveys indicate that the majority of plans are integrated, that small plans are more likely to be integrated, and that nonunion plans are more likely to be integrated. Less integrated benefit formulas produce higher earnings replacement rates particularly for low-wage earners.[4] Based upon this, weal supports the proposal presented under section 4 of H.R. 6410.

Weal is concerned about current social security integration practices because they exclude many women workers from participating in pensions and collecting retirement benefits above the pitifully inadequate social security OASDI benefits. We feel that this legislation, as well as other badly needed pension reforms, is necessary to improve the economic status of retiring women workers.

CONCLUDING COMMENTS

Weal commends the committee for holding these hearings and giving serious consideration to the provisions included in H.R. 6410 that would provide more equitable treatment of rank and file employees. Weal plans to present a more detailed statement concerning section 4 as well as other sections of this legislation in writing to the committee by June 18, 1982. Thank you for allowing me to present this testimony today and thank you for supporting H.R. 6410 and pension equity.

SUPPLEMENTAL STATEMENT OF THE WOMEN'S EQUITY ACTION LEAGUE

This supplement reflects the views of the Women's Equity Action League (WEAL) regarding the Pension Equity Tax Act of 1982. On June 10, 1982, Patricia Blau Reuss, Legislative Director of WEAL, appeared before the Committee to testify in support of H.R. 6410. This statement expands the coverage of WEAL's original testimony to include specific comments on Section 2—overall limits on contributions and benefits—and Sections 5 and 6—rules applicable to plans of professional service corporations. Portions of the June 10 testimony pertaining to Section 4—integration with Social Security—and an overview of the situation for women in private pension plans have been incorporated into this statement.

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[2] Rogers, Gayle Thompson, "Vesting of Private Pension Benefits in 1979 and Change From 1972," Social Security Bulletin (July 1981).

[3] Dittman, Cynthia C., "coordination of social security and employee pensions," paper prepared for the president's commission on pension policy (January 1981).

[4] Schmitt, Raymond, "Integrated Pension Plans: An Analysis of Earnings Replacement," congressional research service (1/5/1981).

WEAL wants to again commend Congressman Rangel for introducing this legislation and the Committee for holding these hearings. WEAL believes that the intent of the various provisions under H.R. 6410 would result in more equitable pension and benefit programs for all workers including the rank and file . . . and that means WOMEN.

Before addressing specific sections of the bill a brief summary of the pension situation for women employed in the private sector seems appropriate since such an overview is relevant to the topic of pension equity.

WOMEN AND PRIVATE PENSIONS

According to a survey covering private industry employment in 1979, about 50 percent or 30 million full-time workers were covered by private retirement plans.[1] The coverage rate for full-time men was 55 percent compared with a coverage rate of 40 percent for full-time women. (The rate for all women drops to 31 percent when part-time workers are included.) Why is a smaller proportion of women workers covered by private pension plans? A Social Security Administration analysis concludes:

Part-time workers are less likely to be covered—30 percent of all women workers in 1979 were part-time compared to 11 percent of all male workers;

Most workers under age 25 are not eligible to participate in pension plans—about 25 percent of working women are between the ages of 16 and 25;

Union members are more likely to be covered than non-union members—only 14 percent of women workers were union members in 1979 compared with 30 percent of the male workforce;

Small nonunion retail and service industry establishments provide poor if any coverage—4 out of every 10 women in 1979 were employed in these types of businesses;

Pension coverage is closely correlated with earnings—only 10 percent of workers with annual wages of $5,000 were covered in 1979 while 70–80 percent of workers with incomes of $15,000 or more were covered. The median annual earnings for women covered by retirement plans in 1979 was $10,500 compared with $17,400 for men.

The scenario for women deteriorates further when one examines their actual participation in employer pension plans. Of the 22 million private sector full-time women workers surveyed by the Social Security Administration, about 9 million were covered, but less than one-half had attained vested status (i.e., the right to benefits upon retirement based on number of years of "covered" employment.)[2] This means that less than 15 percent of women working full-time outside the home in the private sector had acquired the right to participate in and eventually retire on the benefits of a private pension plan.

A major reason that so few women are "vested" is based on their low job tenure rates. Many leave the job market to have families just at the age when pension participation begins. Most women are rank and file employees with unique and intermittent working patterns, including high job turnover. Even if private pension coverage were universally available, women would still have difficulty fulfilling the requirements for vesting and evenutally collecting.

In addition, the current rules related to the integration of Social Security benefits in private pension benefit formulas further reduce the proportion of low income workers—that is WOMEN—who actually receive retirement benefits from private employer plans, since many of these employer-sponsored programs under IRS offset provisions pay no benefits to low income workers or to workers with short tenures.

OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

WEAL supports the provisions of H.R. 6410 that would reduce overall dollar limits for annual benefits payable under defined contribution plans to $30,000 and defined benefit plans to $90,000, repeal the cost-of-living adjustment for these amounts, and reduce the aggregate limit applicable to employees under multiple plans. The original intent of the provisions of the Internal Revenue Code that grant favorable tax treatment to employers administering qualified plans was to provide an incentive to participating businesses to provide retirement income to almost all workers.

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[1] Beller, Daniel J., "Coverage Patterns of Full-Time Employees Under Private Retirement Plans," *Social Security Bulletin* (July 1981).

[2] Rogers, Gayle Thompson, "Vesting of Private Benefits in 1979 and Change from 1972," *Social Security Bulletin* (July 1981).

Unfortunately this equitable distribution of pensions has not occurred, and only about one-half of all full-time workers in private industry are covered by pension plans. Indeed, this level may constitute a peak in the proportion of workers that will ever be covered. A recent analysis, prepared for the National Commission on Social Security Reform, indicates that "private plan coverage may stagnate or shrink in the future, due possibly to contracting employment in manufacturing and transportation and other areas of heavy pension plan concentration." [3] The study also states that "coverage has been extended to those most desirous and able to afford it. Those remaining uncovered are more difficult to cover." [4]

Simply stated, the incentive hasn't worked and it is hard to defend the current allowable levels for high earners when the rank and file still face little of no pension coverage. Under Section 2 of H.R. 6410 individuals who earn enough money to resent the reduced, but still remarkably generous, contribution and benefit ceilings, still have economic advantage (e.g. disposable income for investment and savings) over the rank and file.

In 1978 the median annual income received by the 1.3 million women aged 65 and older who were eligible to collect private pensions or annuities was $1,420 (compared to 2.4 million men with $2,480).[5] In 1978, only 12 percent of the 8.6 million unmarried women aged 65 and older (including 7.1 million widows) received benefits from their own (or their deceased husbands) private pension plans, with the median income of these benefits just under $1,500 a year.[6] Based on the facts: that working women, as taxpayers, subsidize these pension plans; that the overwhelming majority of women do not benefit from these plans; and, that most retired women today depend almost solely on Social Security and other government-funded programs which are under attack by the current Administration's budget cuts—those highly compensated individuals who do reap the benefits of the IRS tax breaks should be thankful that they are not an aging widow. The government should not subsidize these high earners while they further impoverish the aging poor. The revisions proposed by H.R. 6410 are a beginning at balancing the scale.

INTEGRATION AND HOW IT AFFECTS WOMEN

One of the major principles used in determining Social Security OASDI benefits has been to provide greater income replacement of preretirement earnings to low-wage earners than high-wage earners. In conjunction with this Social Security policy, the original and well-intentioned design of integration as a tax policy was to prevent pension plans from discriminating in favor of highly compensated employees and to ensure that lower income people also benefited from these tax breaks. In fact, the current nondiscrimination rules in pensions encourage rather than prevent discrimination in favor of the highly paid.

For those plans that are integrated to a significant degree with Social Security, the result is that lower income individuals receive little or no company benefits. Although data pertaining specifically to women's participation in integrated plans is not readily available, it appears that many women do participate in integrated plans since surveys indicate that the majority of plans are integrated, that small plans are more likely to be integrated, and that nonunion plans are more likely to be integrated. According to a study of integrated plans by the Congressional Research Service, less integrated benefit formulas produce higher earnings replacement rates particularly for low-wage earners.[7] Based upon this, WEAL supports the proposal presented under Section 4 of H.R. 6410.

WEAL is concerned about current Social Security integration practices because they exclude many women workers from participating in pensions and collecting retirement benefits above the pitifully inadequate Social Security (OASDI) benefits. In 1978, the median annual income based on Social Security benefits for nonmarried women (primarily widows) aged 65 and older was $2,830. In fact, the median annual income from all sources (e.g. earnings, social security, retirement benefits, interest from assets, etc.) for women in this group was less than $4,000.[8]

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[3] Bernstein, Merton, "Problem Areas in Private Pensions and State and Local Government Pensions," General Memorandum of the National Commission on Social Security Reform (May 4, 1982) p. 1.

[4] Ibid.

[5] Grad, Susan, "Income of the Population 55 and Over, 1978," Staff Paper No. 41, U.S. Department of Health and Human Services, Social Security Administration, (December 1981) Table 24.

[6] Ibid., Table 2.

[7] Schmitt, Raymond, "Integrated Pension Plans: An analysis of Earnings Replacement," Congressional Reserach Service (January 5, 1981).

[8] Grad, Tables 15 and 8-A.

RULES APPLICABLE TO PROFESSIONAL SERVICE CORPORATIONS

Women constitute the majority of individuals who work in professional service businesses. More than 97 percent of all secretaries (including legal and medical secretaries), dental assistants and receptionists are women. The proportion of women represented in the "professions," however, is signifcantly lower. Table 1 presents an overview of employment and earnings for women and men in these occupations.

Despite the tremendous tax advantages afforded professionals who have incorporated—again we cite the intent of the current favorable tax provisions as a means to encourage expansion of coverage to all workers, not just owners or the highly compensated—the vast majority of employees in these organizations do not obtain the right to receive employer plan benefits upon retirement.

The coverage rate for full-time working women in nonunion establishments with fewer than 100 workers is 22 percent—less than 10 percent vest;

The coverage rate for full-time women in all service industries is 32 percent—less than 13 percent vest in professional service establishments;

The coverage rate for full-time women working in all private sector industries with annual wages of $5,000–$9,999 is 34 percent (8 percent for those with wages below $5,000)—about 10 percent vest.[9]

Furthermore, these facts exclude a significant number of part-time workers who are employed by professional offices and rarely benefit from employer-provided pension plans.

TABLE 1.—MEDIAN ANNUAL EARNINGS FOR FULL-TIME WORKERS IN SELECTED OCCUPATIONS [1] 1981 ANNUAL AVERAGES

[Employment in thousands]

Occupation	Total	Annual earnings	Men		Women		Percent women workers
			Number	Earnings	Number	Earnings	
Total (all occupations)	72,491	$15,028	43,888	$18,044	28,603	$11,648	39.5
Accountants	960	19,708	579	22,516	381	16,016	42.8
Architects	60	22,256	57	22,464	3	(2)	39.7
Engineers	1,459	28,080	1,392	28,444	68	19,292	4.7
Lawyers	279	28,392	219	29,848	60	21,164	21.5
Legal secretaries	159	13,520	1	(2)	158	13,520	99.4
Receptionists	458	10,400	9		449	10,348	98.0
Stenographers	55	14,300	7		48		87.3
File clerks	230	9,984	37		192	9,828	83.5
Typists	801	11,076	29		772	10,972	96.4
Secretaries (excluding legal and medical)	2,969	11,908	20		2,949	11,856	99.3
Physicians, medical and osteopathic	189	26,052	148	29,172	41		21.7
Registered nurses	924	17,264	39		885	17,212	95.8
Therapists	199	15,860	65	17,420	134	15,236	67.3
Health technologists and technicians	511	14,924	161	16,848	350	14,196	68.5
Medical secretaries	71	11,336	0		71	11,336	100.0
Dental assistants	97	9,516	3		95	9,464	97.9
Health aides, excluding nurses	220	10,868	38		182	10,452	82.7
Nursing aides, etc	832	8,944	130	10,556	701	8,684	84.3
Practical nurses	263	11,804	6		256	11,804	97.3

[1] Excludes earnings from self-employment

[2] Employment and earnings data provided for workers employed full-time in occupations with total employment of 50,000 or more.

Source: Rytina, Nancy F., "Earnings of Men and Women: A Look at Specific Occupations," Monthly Labor Review, Bureau of Labor Statistics, April 1982, pp. 25–31.

The tax incentives have become tax shelters favoring already affluent professionals. Since so few benefits flow down to support persons—the secretaries, dental assistants, paralegals—there is little reason to continue providing these tax advantages at current allowable levels unless we call these shelters what they are—rewards for the high earner. It is unethical to pretend these are measures that bring pension equity to the rank and file.

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[9] Based on tables in Beller and Rogers articles.

In addition to the revenue that will be gained by eliminating these excessive tax shelters, WEAL is extremely interested in the proposed extension of rules applicable to plans benefiting self-employed individuals to include professional service corporations. This would hopefully increase coverage for support workers since those with three years of employment would be included in a plan and immediately vested. We assume this would partially eliminate one of the major obstacles to women's participation in private pension plans—unreasonable tenure requirements for vesting. Given the high turnover rates for women in support roles in service-related businesses, most women do not benefit from current practices that allow plans to have 10 year vesting requirements or small plans to offer 40 percent vesting after 4 years (with 100 percent after 11 years) of covered employment. WEAL believes that this particular provision of H.R. 6410 is a step in the right direction—that is toward the elimination of inequities that currently exist in this nation's private pension system.

CLOSING COMMENTS

WEAL believes this legislation may provide a mechanism that can be used to resolve a few of the glaring inequities present to today's private pension programs. Although many of the policies associated with H.R. 6410 are complex and require careful scrutiny, WEAL hopes the Committee will continue to proceed in its deliberations in a timely fashion as already demonstrated by the scheduling of these hearings. WEAL would like to work with the Committee on H.R. 6410 and would be pleased to offer any addiitional information or analysis the Committee might need regarding the experience of women in private pension plans.

Thank you for your support of pension equity for all workers.

Mr. RANGEL. Thank you.

Mr. Conable?

Mr. CONABLE. I believe our major concern should be to try to get more and not less private pension plans. Would the effect of the legislation be to encourage more plans or less? I think it is too bad to have women almost totally dependent on social security. I acknowledge that there are problems in the design of ERISA that tend to exclude women from full participation in ERISA.

I am always faced with the dilemma of if we make the process too expensive and if nobody is mandated to have a private pension plan, the result is that we frequently wind up with less and less coverage, and it does not work to the advantage of women, that is the dilemma, that is the paradox.

If we had mandated private pension plans it would be something quite different. So it is a difficult issue, and one that involves striking a balance in which we will expand coverage to try to include those who are left out now in very substantial degree rather than to make the coverage requirements militate against the formation of private pension plans. I am saying that not in argument with you about your concerns, but to express some of the dilemmas that face us here when we are dealing with a volunteer system as opposed to social security, which is a mandatory system and which may need some reform for the benefit of women also.

Ms. REUSS. Thank you. We feel that social security cannot be the only retirement income for anyone in America, and unfortunately for women, that is all they have to turn to. I think that private employers—the doctors, attorneys, accountants, craftspeople, and actuaries—when they finally recognize through salary and monetary benefits the worth of their rank and file, this is when we will be working with them and the rank and file to get that recognition, maybe without Federal intervention or loss, and get those pensions established.

Mr. RANGEL. How did you say you want to do this?

Ms. **Reuss**. That the employers and employees may not need Federal intervention to get adequate pension coverage.

Mr. **Rangel**. The problem we have is to find out how many billions of dollars we have to give away without taxes to put these pension plans together so that more can trickle down to the rank and file. It is clear that if we try to cap those tax-deferred benefits, they will get out of this completely and shelter their money in some other loophole.

Mr. **Conable**. In the tax-exempt bonds that the gentleman also wants to regulate. The IDB's and others.

Mr. **Rangel**. I am not against tax loopholes. I just want the rank and file to benefit. Don't get me wrong. We have got to save some money, Mr. Conable. I want to make certain we save it from those people not passing any of the benefit to those that don't have adequate pension plans.

Mr. **Conable**. You and I are in very close agreement.

Mr. **Rangel**. We are, and I hate to believe that reducing a plan with $47,000 contributed to $30,000 is going to cause these good employers to close the camp and not allow the rank and file to participate or a $136,000 benefit being reduced to 90,000 is going to cause them to be so angry that they are going to close down.

Mr. **Conable**. Wouldn't that be a tragedy?

Mr. **Rangel**. We believe that this should be worked out with employers and—

Ms. **Reuss**. That is my ideal world.

Mr. **Rangel**. We need legislative incentives to get it working. I thank the panel for their contribution. The record will remain open in case there are other things you would like to say that we neglected to ask.

The last panel for the day is the Edison Electric Institute: Paul A. Perry, corporate secretary, Consumers Power Co.; the National Employee Benefits Institute, Donald J. Christl, counsel; the Pension Rights Center, Karen Ferguson, director, and Stephen Bruce, staff attorney. Small Business Council of America: Converse Murdoch, Murdoch & Walsh; the Working Women Education Fund: Wanda Flowers, staff council.

On behalf of the Chair and the full committee, we thank you for your patience and waiting. I would like Mr. Perry to start.

STATEMENT OF PAUL A. PERRY, CORPORATE SECRETARY, CONSUMERS POWER CO., EDISON ELECTRIC INSTITUTE

Mr. **Perry**. My name is Paul A. Perry. I am corporate secretary of Consumers Power Co. I am pleased to be here to give you the views that I have.

Mr. **Rangel**. Your full statements without objection from the committee will be entered into the record so that you can feel free to highlight it or to add to it.

Mr. **Perry**. I am pleased to be here today to offer my views. I only have four points to make. First, with regard to integration, we believe that the proposed rules would result in severe inequities between our employees because employees earning approximately $24,000 a year and below would have an income after retirement of at least 100 percent of their final pay whereas persons above that level would see that income ratio progressively decline.

Any employee with 100 percent or more of replacement income ratio would probably retire resulting in a loss to the Government of social security taxes from the employer and the employee while social security is also paying benefits. If enacted, this provision could cost the company approximately $6 million per year, representing about 25 percent, which would mean a loss in revenue to the Government.

Second, with regard to loans under the 401(k) provision, this proposal to tax the proceeds of loans as income would seriously discourage participation in this type of plan. In capital accumulation plans, the more restrictions that are placed on the accessiblility of the money to participants, the less will be the use of these worthwhile plan provisions.

In our discussions with employees, it has been the younger and lower paid employees who are most concerned about the availability of these contributions. Incidentally, I might point out we do have a pension plan, we have offered our employees the opportunity to have an IRA plan; and we have now the 401(k) plan. So we have a pension plan completely paid for by the company; we have a plan, the IRA, which is completely financed by the employee and of course that money would not be available before 59½ and so we feel that the 401(k) plan should have provisions where there could be loans to the employee if the employee has a severe need for that money before 59½.

The existence of a loan does not diminish revenue to the Government because at the time of distribution, the employee's entire balance, whether he has an unpaid loan or not will be subject to tax.

Third, on limits on benefits and contibutions for individuals, a reduction in the maximum of the $90,000, while on its face appealing, has very serious implications, not for the very top employees, but for the middle income individuals.

Experience tells us that the very top individuals can be taken care of and we have addressed those ways throughout the day. We are concerned really about lower and middle income employees who are below the $40,000 range who upon retirement will be earning more than enough to run into this limitation because the inflation adjustment is to be removed.

We object to the concept that benefit plans are designed for a few high paid executives. In our company's plans and most company plans, we know about, we try to honestly design benefit plans to meet the needs of all employees. Discriminatory plan design is by far the exception rather than the rule in private industry.

For example, without any Government requirements our company and others have placed such things as pre-retirement counseling programs in operation to keep the employees informed with respect to their benefits under the benefit plans. Our company does care about its employees.

Fourth, there may be a negative impact on capital formation as a result of this bill. Private pension systems constitute a major source of private investment capital. Reductions in benefits will substantially reduce the growth of that pool of capital. The effect will be particularly onerous with regard to the electric utility industry.

This industry is an investor in approximately 30 percent of all new corporate security issues in the United States. Any reduction in the availability of that pool of capital will only exacerbate the present precarious financial health of the electric utility industry.

Mr. RANGEL. Thank you, Mr. Perry.

[The prepared statement follows:]

STATEMENT OF PAUL A. PERRY, SECRETARY, CONSUMERS POWER CO.

Mr. Chairman and Members of the committee, my name is Paul A. Perry, Corporate Secretary of the Consumers Power Company in Jackson, Michigan. I am accompanied by Thomas A. McNish of my company. We are here today representing both the views of the Consumers Power Company and the Edison Electric Institute (EEI). The Institute is the national trade association of investor-owned electric utility companies. Its members provide about 78 percent of the nation's electricity, serving over 67 million customers.

We are pleased to have the opportunity today to offer our individual corporate views as well the views of EEI on the Pension Equity Tax Act of 1982, H.R. 6410. I will begin my statement by commenting from a corporate perspective and conclude with a more general industry overview.

Consumers Power Company is a public utility engaged in the generation, purchase, transmission, distribution and sale of electricity to 1.3 million customers, and in the purchase, production, storage, transmission, distribution and sale of natural gas to 1.1 million customers, all in Michigan's lower peninsula. The Company reported total assets of $5.9 billion at December 31, 1981, and sales of $2.7 billion, and net income of $180 million more for the 12 months then ended. Consumers Power Company's accounting is regulated by the Federal Energy Regulatory Commission and the Michigan Public Service Commission. The Company's securities are listed on the New York and Midwest Stock Exchanges.

INTEGRATION OF PENSION PLANS WITH SOCIAL SECURITY

We have one pension plan covering all our employees: salaried, clerical and union. Presently, the assets of the Plan are approximately $350 million. We have 12,000 active employees and 3,700 retirees. Our annual contribution is approximately $30 million and payments to retirees approximate $16 million per year. The Plan utilizes a final pay concept integrated with Social Security. The formula will provide a maximum of 63 percent of final pay (average of five highest years) offest by 50 percent of Social Security benefit. Employees can retire as early as age 55 at 65 percent of their accrued benefit which is increased by a supplement until the pensioner is eligible for Social Security.

Our understanding is that this is a common way of providing reasonable and adequate retirement income for all our employees. Surveys of our employees have shown a very high degree of satisfaction with our Plan.

If this proposed bill were adopted, we estimate that the change in Social Security integration rules would result in additional cost to the Company of approximately 3 percent of our payroll, i.e., $6,000,000 a year.

We also believe that the proposed rules would result in severe inequities between our employees because individuals earning approximately $24,000 and below would have an income after retirement of at least 100 percent of their final pay whereas persons above that level would see that income ratio progressively declne. It also occurs to us that any employee with 100 percent or more replacement income ratio would probably elect to retire which would result in loss to the government of Social Security taxes from the employer and employee while also paying benefits.

We further believe that these proposed rules will potentially create inter-generational inequalities. Through 1981, the amount the Company has paid in Social Security taxes for an employee is $13,870; though 1982 the figure is $16,041. This means that 13½ percent of the total was paid in 1982. Therefore projecting the fact of larger Social Security tax payments into the future would mean that eventually a permissible integration level would be 100 percent of an employee's pension benefit.

LOANS TO PLAN PARTICIPANTS

At our company we have recently adopted in IRC Section 401(K) option for our employees' Savings Plan. It contains a loan provision in reliance on existing rules. We have just completed extensive communication efforts with our employees. We took this action to implement what we understand to be a national policy, i.e., to encourage individual savings and capital accumulation for retirement. The President's Commission on Pension Policy established by President Carter strongly urged tax incentives to foster this objective. Congress in the Tax Revenue Act of 1978 and the Economic Recovery Tax Act of 1981 sought to encourage investment savings. As a Company, we agree with this national goal.

This proposal to tax the proceeds of loans as income will seriously discourage participation in this type of plan. In capital accumulation plans, the more restrictions that are placed on the accessibility of the money to participants, the less will be the use of these worthwhile plan provisions. From our recent experiences, it has been the younger and lower paid employees who are most concerned about the availability of their contributions. They are concerned about major items such as paying for college educations for their children and down payments for homes.

Rules already exist which require the orderly payments of such loans. In any event, the existence of a loan does not diminish revenue to the Government because at the time of distribution the employee's entire balance, whether he has unpaid loan balance or not, will be subject to tax. We fail to see how this proposed restriction would enhance Government revenues. We strongly urge this Committee to reconsider this "ban" on loans because of its adverse effect on the national goal of increasing retirement savings.

LIMITS ON BENEFITS AND CONTRIBUTIONS FOR INDIVIDUALS

The reduction in the maximum limit to $90,000, while on its face appealing, has very serious implications not for the very top employees but for middle income individuals. First the limit at age 55 could be $37,800 under the proposal, and the inclusion of post-retirement medical benefits would further reduce the limit. In our situation, such medical benefit is presently approximately $2,800 at maximum. If the employee wishes to provide a benefit for his spouse his pension benefit would be further reduced. Experience tells us that the very top individuals will be taken care of: we are concerned about the lower and middle level employees below the 40,000 range, who upon retirement will be earning more than enough to run into this limitation because the inflation adjustment is to be removed. This arbitrary limit will, it seems to us, require adjustment in the future to take into account economic reality, and we are concerned that it will not be politically feasible to do so.

Such limitations, in our opinion, would also violate the spirit if not the letter of ERISA which prohibits employers from reducing accrued or promised pension benefits.

CONCLUSION

We strongly object to the apparent underlying concept of the bill that benefit plans are designed for a few rich executives. The fact of the matter is that our Company and most companies honestly try to design benefit plans to meet the needs of all employees. As a general observation, discriminatory plan design is by far the exception rather than the rule in private industry. For example, without any governmental requirements, our Company and many others have in place extensive preretirement counseling programs. We do care about our employees.

GENERAL INDUSTRY OVERVIEW

A great deal of industry concern has been voiced with regard to Sections 2, 3, and 7 of H.R. 6410. A discussion concerning these sections is set forth below.

LOANS TO PLAN PARTICIPANTS (SEC. 3 OF THE BILL)

Loans to employees are currently permitted under nondiscriminatory standards that require loans to be reasonably and adequately secured. The adoption of a more restricted loan policy will detrimentally affect lower and middle level employees. Prohibiting loans to upper echelon employees may cause some plans to prohibit loans to middle and lower level employees as well. The inability of these employees to borrow from their plan may aggravate existing financial difficulties which they face in today's economic climate.

The broad prohibition against loans in cash deferred plans will discourage younger and lower paid employees from accumulating funds for retirement. This effect runs directly counter to the stated objectives encompassed in last year's tax bill which were to encourage the younger segment of the working population to avail themselves of alternative private methods of saving for retirement and to shift part of the responsibility for future generations' retirement security from the government to the individual.

Retirement security from the government to the individual. Furthermore, the ability to borrow encourages employers to adopt plans and encourages employees to participate in plans. Loans enable employees to have access to a ready loan source in times of economic hardship such as these or other financial emergencies.

LIMITS ON BENEFITS AND CONTRIBUTIONS FOR INDIVIDUALS (SEC. 2 OF THE BILL)

A. Impact on rank and file employees.—Section 2 of the Bill would drastically reduce the limits on contributions and benefits established by ERISA subsequent to thorough Congressional consideration and debate. Changing these limits may have far-reaching, detrimental effects not contemplated by this Bill.

Specifically, the bill will have an adverse impact upon middle level, rank and file employees. For example, because retirement plans are subject to elaborate nondiscrimination requirements, the pensions provided to lower paid individuals are usually based upon the pensions provided to more highly paid individuals. Therefore, the limits for the more highly paid individuals will have the effect of reducing pensions for rank and file employees.

This result will be compounded if the "1.4 rule" is repealed. Under present law if the same employee is covered by both a defined benefit and a defined contribution plan of the same employer, that employee is entitled to receive contributions and benefits of up to 140 percent of the total which that employee would otherwise be entitled to if covered by only one type of plan. Under H.R. 6410 the percentage of contributions and benefits will be limited to 100 percent. This could have the result of repealing some thrift or savings plans which benefit rank and file employees.

Additionally, results of this rule will be that the cutback in the overall benefit limitations will cause the termination of numerous plans benefiting rank and file employees.

B. Impact on Capital Formation.—A second area in which this bill will have a detrimental effect is that of capital formation. Private pension system constitute a major source of private investment capital. Reductions in benefits will substantially reduce the growth of that pool of capital.

The effect will be particularly onerous with regard to the electric utility industry. The industry is an investor in approximately 30 percent of new Corporate Security issues in the United States. Any reduction in the availability of that pool of capital can only exacerbate the present precarious financial health of the electric utility industry.

STATUTORY FRINGE BENEFITS (SEC. 7 OF THE BILL)

H.R. 6410 would establish new nondiscrimination standards for many forms of statutory fringe benefits, including well established benefits such as health insurance and group life insurance. Once again, such standards would have their most egregious effect upon the rank and file employee. For instance, by effectively limiting benefits for upper echelon or key employees, the Bill will result in benefit cutbacks or elimination or benefits for rank and file employees in important areas such as life insurance coverage.

SUMMATION

The potential detrimental impact H.R. 6410 may have upon the industry's rank and file employees has been set forth above. Moreover, a serious concern arises with the seemingly regressive aspects of this legislation in the vital area of capital formation.

For the reasons outlined herein, the Edison Electric Institute must speak out in opposition to H.R. 6410.

Mr. Chairman, I appreciate the opportunity to offer to this committee the views of both my Company and the Institute.

Mr. RANGEL. Donald Christl.

STATEMENT OF DONALD J. CHRISTL, COUNSEL, NATIONAL EMPLOYEE BENEFITS INSTITUTE

Mr. **Christl.** I am Donald J. Christl, attorney with the Milwaukee, Wis., law firm Reinhart, Boerner, Van Deuren, Norris & Rieselbach, s.c. I am appearing on behalf of my firm and its clients, also as counsel to the National Employee Benefits Institute. My firm represents about 1,000 pension plans covering hundreds of thousands of individuals. The National Employee Benefits Institute represents both Fortune 1,000 and smaller employers. Those employers account for more than $25 billion of pension assets, over 5 percent of the total pension reserves now existing in the United States.

As other speakers, for brevity, I will depart from my written text and highlight areas of particular significance.

In general, the NEBI supports the objective recited by Congressman Rangel for H.R. 6410. In his words, "that objective seeks to create a greater incentive for the comprehensive inclusion of the broadest possible class of employees in pension plans." We believe, however, that H.R. 6410 would not accomplish that objective and, therefore, oppose its adoption.

The private pension system today protects 60 million workers. It constitutes a pool of $450 billion for long-range investment in American industry. The Federal Reserve System projects that, if the pension system continues in its present mode, by the year 2000 its assets will equal $3.5 trillion, 25 percent of all American investments.

With the Social Security System overburdened and the economy undercapitalized, logic suggests that Congress seek ways of strengthening the private pension system, relieve the burden on social security and enhance the assets available for long-term investment in the American economy.

I will address three areas of H.R. 6410 that we believe do not accomplish those purposes.

First, rather than create an incentive for extending greater pension benefits, H.R. 6410 creates an incentive for reducing benefits. Many speakers have addressed the limits appearing in section 2 of the bill as creating a disincentive to employers for maintaining plans. Granted, it is not very easy to be sympathetic with individuals earning over $100,000 a year and enjoying pension contributions or benefits equaling $45,000 or $136,000 a year, but let me give an example the panel requested on how, by affecting those people, section 2 would also affect the rank and file.

As you know, current law requires parallel benefits for rank and file workers as for the highly compensated. Thus, if a defined contribution plan required contributions of $45,000 for an individual earning $180,000, by law it must require a contribution of $5,000 for an employee earning $20,000.

If the $45,000 contribution dropped by law to $30,000, the inevitable result would be a reduction in the $5,000 contribution for the rank-and-file employee to $3,300.

Mr. **Rangel.** Why is that inevitable?

Mr. **Christl.** Because employers are economic creatures and, although the change may not happen instantly, I believe it naively optimistic to expect that if an employer reduces the executive's benefits from 25 percent of pay to 15 percent of pay, absent some other pressure, it would indefinitely continue to provide the rank and file benefits equaling 25 percent of their pay.

Ultimately, the reduction in the cap for the highly paid would be felt by the rank and file. The large majority of the employees are rank-and-file employees. Thus for every individual executive who suffers a reduction in benefits, ultimately a large number of rank-and-file employees will suffer the same reduction.

I understand your concern with the testimony of some of my predecessors that no logical tie exists between the absolute termination of plans and the reduction in benefits. I do believe, though, that a very logical tie exists between the reduction in benefits for the executives and the ultimate reduction in benefits for the lower paid rank and file employees.

Second, the thrust of H.R. 6410 discriminates against a group in our economy that has not yet been mentioned too strongly, the small- and middle-sized employer. Ninety percent of the people participating in the private pension system participate in plans covering fewer than 100 individuals each; thus, whatever affects the small employers will affect the largest portion of the participants in the private pension system. Almost by definition, the personal service employers who would feel the impact of section 6 in H.R. 6410 are small employers.

By the thrust of most of the discussion that occurred today, the employers who would feel the sting of the reduction in the benefits for the highly compensated are the small employers. Those effects would induce the reduction of benefits for the employees of those smaller employers, a very substantial portion of our economy, and I might add in relation to one of the prior speakers, a very substantial portion of whom are women.

An earlier speaker commented that reduced pension benefits for higher compensated employees could be replaced by high nonqualified deferred compensation programs. For the most part, that option is available only to larger employers.

As I am sure you realize, by law, nonqualified deferred compensation plans constitute merely the employers' unsecured, unfunded promise to pay employees benefits in the future.

Such plans presume the continued existence and prosperity of the employers. A small employer who is bidding for a skilled employee, say against an Exxon or a General Electric, would have a difficult time matching with a promise of future pay the security granted that individual by a promise of future pay from a large company. That large segment of the economy constituting small- and middle-sized employers would be hurt, which would hurt not only its executives but the rank and file and women employed therein as well.

Last—and I will conclude with these objections—if as some people have indicated, and Congressman Rangel has characterized them, many executives and owners of businesses are strongly economically motivated and eager for tax shelters, upon adoption of H.R. 6410, money now contributed to the pension system will go to them in forms of other compensation and then be used for other tax shelters.

Thus, even the modest figures the Treasury Department proposes would not occur as increases in tax revenue. The money channeled out of the private pension system and its long-range investment in the economy would likely go to other investments not as beneficial to the economy, and certainly not as beneficial to the rank-and-file workers now covered by pension plans.

H.R. 6410 would result in equity only by causing everyone to receive less. It would impose substantial costs on employers to comply with the new law, it would not generate new revenue for the Government and would erode the investment available now to the national economy from the private pension system.

We therefore submit that the committee would best serve its constituents, the Nation, by refusing to report out H.R. 6410.

Thank you.

[The prepared statement follows:]

STATEMENT OF NATIONAL EMPLOYEE BENEFITS INSTITUTE

INTRODUCTION

The National Employee Benefits Institute ("NEBI") represents more than $25 billion in pension assets. NEBI was formed in 1977 to provide members direct contact to all levels of administrative agencies and departments in Washington. The Fortune 1,000 Companies participating in NEBI are leaders with respect to pension planning and are concerned with pension legislation and regulations.

Most of the comments appearing below apply equally to large and small employers. However, these comments will, as indicated, focus at times on areas of the Bill which present special concerns for large and small employers separately.

We support the efforts of Congress to police and strengthen the private pension system. In 1974, the Employee Retirement Income Security Act ("ERISA") introduced federal legislation in many areas governing pension plans and other employee benefits. For the most part, the American employers and employees found the ERISA requirements acceptable and to enhance the employees' security and the employers' resultant productivity. H.R. 6410 would substantially alter many of the basic principles ERISA established for retirement and other fringe benefit programs. We urge Congress seriously to consider the consequences of those changes and to measure the appropriateness of those changes in relation to the nation's experience pursuant to ERISA, the current state of the nation's public retirement program. Social Security, and the current condition of the American economy.

SUMMARY

H.R. 6410 would impose inappropriate limits on the private pension system and generate undesirable results for the American economy because of the following reasons:

1. Forcing the reduction of pension benefits and contributions for the owners and executives of businesses will induce a proportionate reduction in benefits and contributions for all employees. As a result, millions of rank and file employees will suffer a loss of pension protection due to the limits on pension contributions and benefits imposed by the Bill.
2. Diminished pension benefits and contributions will reduce the long-range investment pool created by pension plans, depriving American industry of much needed capital during this period of economic adversity.
3. Further restricting retirement plans' integration with Social Security will render such plans more costly to the employers maintaining them, leading such employers to reduce the benefits for all employees, reduce other compensation paid those employees or terminate the plans.
4. Imposing Keogh Plan limits and requirements on retirement programs of personal service corporations saddles the members of the personal service industries with a discriminatory benefit reduction lacking purpose or rationale.
5. Imposing increased coverage requirements on health, life and other fringe benefits renders those programs more expensive to employers. Employers must respond by restricting the programs for all or terminating them. Such restrictions or terminations will place smaller employers at a distinct disadvantage in seeking skilled

technical and executive personnel versus their larger competitiors able to provide such personnel a wider array of compensation programs.

6. If losing deductions for pension contributions, employers will seek similar tax deductions and tax shelters elsewhere. The contraction in America's investment capital resulting from reduced pension contributions will ultimately reduce the nation's earning capacity. Both factors will cause H.R. 6410 to reduce the government's tax revenue, not enhance it.

7. Lastly, adoption of H.R. 6410 would impose upon the employers maintaining pension plans a cost of almost one-half billion dollars merely in amending those plans to comply with the law.

STATEMENT

I. THE PLIGHT OF THE SOCIAL SECURITY SYSTEM AND STATE OF THE AMERICAN ECONOMY REQUIRE LEGISLATION STRENGTHENING THE PRIVATE PENSION SYSTEM

When introducing H.R. 6410, Congressman Rangel described for it two objectives: "to provide greater incentives for the comprehensive inclusion of the broadest possible class of employees in . . . pension plans" and to reduce what he termed "the excessively high . . . limits on tax-free accumulations under corporate pension plans."

The private pension system today covers over 60 million workers. More than 90 percent of the country's pension plans benefit fewer than 500 employees each and 80 percent of the employees participating in the private pension system are covered by such smaller plans.

Today, the private pension system provides a $450 billion pool of capital for long-term investments in American industry. The Federal Reserve System projects that the pension investment pool may reach $3.5 trillion by the year 2000, at which time those assets, added to the assets of state and municipal government pension plans, will exceed one-fourth of the nation's investment capital, the largest single source of funds for industrial growth and development.

Today, the Social Security system faces unprecedented problems, inducing certain commentators to describe it as "on the verge of bankruptcy." The nation has suffered an economic recession unparalleled since the Great Depression of the 1930's due, in good part, to the lack of capital invested in American industry. The federal government anticipates years of increasing deficits and increasing federal borrowing, thus further consuming capital otherwise available for private investment.

Logic suggests that Congress address the plight of the Social Security system and the nation's need for investment capital by seeking legislation which strengthens the private pension system and encourages contributions to that system for further investment in American industry. Congress must take particular care against adopting legislation which would impair the successful maintenance of retirement plans by smaller employers because of the important part they plan in the private pension system. Statutes discouraging smaller employers from maintaining their plans or inducing them to curtail the benefits provided will reduce the financial security for 80 percent of the individuals participating in the pension system and accordingly contract the pool of investments available for the American economy.

The following testimony examines H.R. 6410 against the objectives defined by its author, the current condition of the Social Security system and the state of the American economy.

II. H.R. 6410 WILL REDUCE PENSION CONTRIBUTIONS AND BENEFITS FOR MOST ALL EMPLOYEES, THUS THREATENING THEIR RETIREMENT SECURITY, IMPOSING GREATER RELIANCE UPON THE SOCIAL SECURITY SYSTEM AND REDUCING THE POOL OF CAPITAL AVAILABLE FOR INVESTMENT

A. Reducing the contributions and benefits allowed for highly compensated employees will reduce the contributions and benefits for all employees. Section 2 of H.R. 6410 explicitly reduces the maximum contributions permitted pursuant to defined contribution pension plans and the maximum benefits provided by defined benefit pension plans. It eliminates cost-of-living adjustments from those limits and restricts the benefits and contributions for a combination of such plans covering the same employees. Proponents of the legislation have described Section 2 as introducing greater equity into the pension system and reducing tax deductions generated by contributions for higher compensated individuals.

Employers forced to reduce executives' benefits and contributions pursuant to H.R. 6410 will also proportionately reduce the benefits and contributions for rank and file employees. The Internal Revenue Code currently prohibits tax-qualified retirement plans from discriminating in favor of officers, shareholders and highly compensated individuals in relation to benefits and contributions. Even if an employer maintains a retirement plan with only the motive of compensating its executives, the Internal Revenue Code requires that the employer provide proportionate benefits for a substantial share of its employees or for a class of employees which the Treasury Department and Internal Revenue Service specifically identify as not discriminating in favor of the prohibited group.

Currently, if a company contributes the maximum $45,475 to a defined contribution retirement plan on behalf of an executive earning $185,000 annually, it must contribute $5,000 to the same plan for each employee earning $20,000 per year. If adopted, H.R. 6410 would require that the employer reduce the contribution on behalf of the executive to $30,000. In almost all instances, particularly for the cost-conscious smaller employer, the employer would proportionately reduce the contribution for other employees, so that the $20,000 per year employee would receive a contribution on his behalf of not $5,000 but of only about $3,300.

If, instead of a defined contribution program, the employer maintained a defined benefit pension plan, the plan may currently provide a benefit of $136,425 for the executive and benefit of $15,000 for the $20,000 per year employee. Adoption of H.R. 6410 would reduce the executives' benefit to $90,000 and likely result in a reduction of the employee's benefit from $15,000 to $10,000.

Most retirement plans cover far more rank and file employees than executives. Therefore, tens or hundreds of workers will suffer the loss of contributions or benefits because of the limits placed on one or a few executives. Section 2 of the Bill removes the cost-of-living adjustments to the contribution and benefit limits. As inflation expands the executives' and employees' annual compensation, the portion of that compensation reflected in pension contributions or benefits would decrease. The rank and file employees may find their pension contributions, now equalling up to 25 percent of their compensation, or benefits, now equalling 100 percent of their compensation, dropping to less than one-half of those amounts in a relatively short period.

B. No rationale exists for changing the Social Security integration rules. In 1971, the Treasury Department and Internal Revenue Service created elaborate rules for integrating retirement plans with Social Security. The rules allowed employers to establish contributions and benefits pursuant to the private system which reflected the contributions employers made to the Social Security system on behalf of the covered employees or reflected the benefits anticipated by those employees from the Social Security system. The Treasury Department and IRS defined those rules as fair and equitable when promulgating them. Hundreds of thousands of retirement plans have complied with the rules and regulations and now reflect integration with Social Security accordingly. The proponents of H.R. 6410 have given no rationale as to the basis for changing the Treasury Department's rules. As explained later, the cost of effecting the changes alone would strike a significant blow against the retirement plans and the employers maintaining them.

Section 4 of H.R. 6410 significantly restricts the integration of pension contributions with employer contributions to Social Security and of pension benefits with the benefits employees anticipate from the Social Security system. Such a restriction increases the cost of pension benefits to each employer and, particularly for a cost-conscious smaller employer, will generate one of three results for its employees: (i) an overall reduction in the pension benefits provided everyone, (ii) a reduction in other compensation paid to or on behalf of the employees or (iii) an outright termination of the programs. In any of these results, the rank and file employees suffer the loss of their present retirement benefits.

C. H.R. 6410 inappropriately saddles professionals with reduced pension coverage. Section 6 of the Bill imposes Keogh Plan limits and requirements on the plans of personal service corporations. For years, certain members of Congress and certain Internal Revenue Service agents have viewed physicians, dentists, attorneys and their fellow professionals as inferior in rights to other citizens. A corporate executive or other employee may legitimately enjoy pension benefits pursuant to programs which, in the eyes of those Congressmen and Treasury agents, would prove illegitimate if provided personal service individuals. In fact, the limits imposed by H.R. 6410 would force professionals to take retirement benefits lower than now provided Congressmen and IRS agents.

For almost all personal service businesses, the ratio of rank and file employees to owners exceeds five-to-one. Due to the proportionality of benefits and contributions between the rank and file workers and the highly compensated, for every one professional suffering a reduction in retirement benefits or contributions because of H.R. 6410, five or more rank and file employees will suffer similar reductions. For each professional induced to terminate his practice's retirement program and seek tax shelters elsewhere, five or more rank and file employees will lose retirement benefits.

D. The restriction on other fringe programs and reduction on pension benefits excludable from taxable estates at death particularly hurt small employers and small plans. A bias against small and medium sized businesses appears in H.R. 6410, which bias becomes exceedingly evident in Sections 7 and 8 of that Bill. Section 7 imposes fringe benefit plans; Section 8 restricts the portion of pension benefits excludable from a decedent's taxable estate.

Due to their limited size and, frequently, their lack of publicly traded stock, small employers may offer their highly skilled management and technical employees less elaborate and less varied compensation packages than larger employers. Yet the small and medium sized businesses must compete with large employers for the nation's pool of skilled individuals. Lacking publicly traded stock, many small companies cannot offer their highly skilled employees stock option and other stock bonus programs. Lacking the financial depth and substance of larger companies, those employers cannot offer non-qualified deferred compensation programs to their executives and technicians as can the large employers. Thus, many smaller companies supplement their executives' compensation programs with health, accident or life protection programs. They also use pension contributions to protect the executives' beneficiaries at death by assuring a transfer of pension benefits to those individuals outside the executives' taxable estates. The availability of such benefits induces executives and highly skilled people to remain with the smaller employers.

H.R. 6410 will increase the cost of life, health and accident benefit programs by requiring the coverage of more employees. Such increased costs will induce employers to chose one of the same three options described above for more costly pension programs: (i) reduce the benefits for all employees, (ii) reduce other compensation paid all employees or (iii) terminate the programs. In all events, the employees lose. In this instance, the smaller employers lose in that the reductions or cessation of such benefit programs places them at a competitive disavantage versus larger employers in attracting the skill and expertise necessary for their success.

Imposing a greater estate tax on pension benefits will reduce the protection such plans provide the beneficiaries of all employees. To attract executives and highly skilled individuals, employers will then be required to replace lost death benefits with other benefit programs or insurance packages. Due to their lack of financial depth and the limited resources available to them, smaller employers will again suffer a disavantage versus their larger competitors in establishing such programs or acquiring such protection.

III. ADOPTION OF H.R. 6410 WILL IMPOSE SIGNIFICANT COMPLIANCE COSTS ON EMPLOYERS MAINTAINING RETIREMENT PLANS, REDUCE THE POOL OF ASETS AVAILABLE FOR INVESTMENT AND CAUSE EMPLOYERS TO SEEK OTHER TAX SHELTERS, THUS NOT INCREASING FEDERAL REVENUE

A. Adoption of H.R. 6410 will place a substantial cost on employers maintaining retirement plans which will result in an inappropriate consumption of assets during this difficult economic period. Compliance with H.R. 6410 would require substanial revisions in almost all pension plans, imposing significant legal and actuarial costs upon the employers maintainin those plans. Adoption of H.R. 6410 will require amendment of almost all the nation's 450,000 pension plans. If 400,000 of those plans each incurred an average of $1,000 in actuarial and legal fees for their amendment (a modest amount in most instances), the cost to the employers maintaining the plans for simply their amendment would equal $400 million. Rather than enhancing the employers' ability to maintain the plans and easing the burdens imposed upon them during these troubled economic times, H.R. 6410 would increase the employers' costs and make continuation of the plans substantially more difficult. The benefits sought by the proponents of the Bill do not justify the costs generated simply in the revision of plans to comply with it.

B. The Bill's reduction in pension contributions and benefits will reduce the annual additions to the pension investment pool, thus reducing assets available for investment in the American economy. A reduction in pension contributions or a termination of pension plans will reduce the investment pool created by those plans. Employers would direct money now used as pension contributions to other purposes, possibly seeking tax shelters less beneficial to the public and economy or removing the money entirely from the investment community. In any event, the American economy suffers.

C. Reduced pension contributions will induce employers to seek tax deductions and shelters from other means, thus not increasing tax revenue. Although H.R. 6410 may reduce employers' tax deductions for pension contributions, it would not increase government revenue. Employers would merely direct the same money to other tax-sheltered expenditures, thus not increasing taxes, and the ultimate weakening of the economy would generate lower incomes on which taxes are paid.

IV. H.R. 6410 WILL REDUCE BENEFITS PROVIDED ALL WORKERS, REDUCE ASSETS AVAILABLE FOR INVESTMENT IN THE ECONOMY AND, ULTIMATELY, REDUCE TAX REVENUE BY REDUCING THE EARNINGS OF THE AMERICAN EMPLOYERS AND EMPLOYEES

If adopted, H.R. 6410 would reduce the pension benefits paid the American workers, not increase them, and achieve fairness in the pension system only by causing everyone to receive less. Even the government would receive less in taxes due to the resultant erosion in the economy and its earning capacity.

The best interests of our clients, their employees, the pension plans participating in the NEBI, the 60 million American workers participating in the private pension system and the nation's economy require defeat of H.R. 6410. I respectfully submit and urge that the Committee will best fullfill its obligations to the country by refusing to report out H.R. 6410.

Chairman ROSTENKOWSKI. Ms. Ferguson, you may proceed.

STATEMENT OF KAREN FERGUSON, DIRECTOR, PENSION RIGHTS CENTER, ACCOMPANIED BY STEPHEN BRUCE, STAFF ATTORNEY

Ms. FERGUSON. I am Karen Ferguson, director of the Pension Rights Center. Appearing with me is Stephen Bruce, the center's staff attorney. We are here to testify in support of H.R. 6410.

Every day the Pension Rights Center hears from individuals angered, outraged, disappointed about what they see as the fundamental unfairness of their private pension plans. These are people not getting the pensions they expected or getting far less than they had expected. I would like to tell you about a few of these people, people who could benefit from provisions such as those in H.R. 6410.

Anna Smith of Columbus, Ohio is one of these people. She recently wrote to us saying that she had retired this past February from J. C. Penney Co. at the age of 66. She had worked at Penney's for 14 years. When she retired, she was told that she was not entitled to a pension. The company told her, "There is no benefit payable to you from the pension plan because the social security retirement benefit as estimated under the plan formula is sufficient to meet the plan's income goal."

Mrs. Smith concluded her letter, bewildered as to what had happened to her, saying, "Now I was 10 years fully vested. I cannot understand how they can deny me any pension, even the smallest amount."

Betty Thomas was equally shocked and confused after 10 years of work at the Red Owl Co. in Minnesota. She was told that even though she had done everything needed to qualify for a pension, she would not receive a thing. Her company told her that even though she qualified for a "vested pension" of $72 a month, they were subtracting half her social security benefits, $99 a month, from her pension—leaving her with nothing.

Her situation is described in our "Guide to Understanding Your Pension Plan," which is attached to this statement.

Then there is the personnel director of a Miami hotel who called a couple of weeks ago furious about his company's excess plan. He is 32 years old and makes $16,000 a year. No pension contributions are made on his behalf because his salary is far below his plan's $29,700 cutoff. He says that under this plan, only the top executives get pensions.

A very similar complaint came from a management employee who works for United Parcel Service in Brooklyn, N.Y. His new-improved pension is based on an amount of salary with social security deducted.

He pointed out that this plan only benefits higher management and discriminates against about 90 percent of all management employees.

These people feel that they are being misled and defrauded. There is no justification as a matter of Federal tax policy, or retirement income policy, for their not receiving pensions.

Every pension actuary and consultant we have talked to has told us that the integration objectives of H.R. 6410 make excellent sense. These objectives, as you are aware, are that employers should not be allowed to subtract more than the social security contributions they have made for their employees. The integration provisions of H.R. 6410 would eliminate windfalls to employers. They basically say that an employer cannot take credit for amounts contributed by another employer, by earlier employers, or amounts attributable to the transfer element in social security.

The provisions in H.R. 6410 merely cut back on Federal revenue losses that have no valid public policy objective. We find it absolutely astonishing that anyone could oppose this long overdue modification of unfair and irrational IRS rules.

I would like to say parenthetically that the Pension Rights Center remains, as we were when we testified before this committee in 1978, flatly opposed to all social security integration. We do not think that employers should be allowed to use pensions to even out the discrimination in favor of lower paid workers that is built into the social security system as a matter of sound public policy. We also do not think that lower paid workers can maintain an adequate standard of living on the same percentage of pay as higher paid workers.

The concepts underlying integration are outdated and unrealistic, and once workers and retirees begin to understand these concepts, they will reject them categorically.

Attached to the statement, as the last item, is an article from the Baltimore Sun, which describes a situation where an employee found out about integration and did something about it. Lee Miller was a wireman for Baltimore Gas & Electric Co. for 32 years. His plan was a lot better than those described in this legislation. In fact, instead of subtracting 83.33 percent or even 50 percent of his social security benefits, it subtracted only 15 percent.

He and his fellow employees were outraged nonetheless. They feel "that money is a part of a worker's wages. These companies have no right to take that money."

His efforts succeeded. Effective June 1, the Baltimore Gas & Electric plan dropped its offset. In the words of the manager of corporate staff services, the integration issue has been a bone of contention for our employees since 1940 because it has been difficult to explain to them what has happened.

In conclusion, let me say very briefly that this is a very timely and important piece of legislation. You are considering today budget alternatives. The role of indirect Federal expenditures is essential to that consideration. Private pensions are the largest of all Federal tax expenditures. That tax expenditure, that tax subsidy, can only be justified if it meets the public policy objective of providing pensions to those people most in need of a supplement to social security.

Mr. RANGEL. Thank you.

[The prepared statement and attachments follow:]

STATEMENT OF THE PENSION RIGHTS CENTER

Mr. Chairman, Members of the Committee, my name is Karen W. Ferguson. I am Director of the Pension Rights Center. Appearing with me is Stephen R. Bruce, the Center's Staff Attorney. We are here today in support of H.R. 6410, the Pension Equity Tax Act of 1982.

As a nonprofit organization committed to the pension interests of workers and retirees, the Pension Rights Center continually hears from individuals who are outraged, both as participants and taxpayers, at what they see as the fundamental unfairnesses of private pension plans. The experiences of many of these people relate directly to the provisions of H.R. 6410 and we would like to share them with you.

INTRODUCTION

Before turning to the specific provisions of H.R. 6410, I would like to commend Congressman Rangel and this Committee for recognizing that budget issues cannot be adequately addressed without focusing on the critical role played by indirect federal tax expenditures. It is both fitting and realistic for your review of these indirect expenditures to begin with a critical examination of the largest of all of these tax expenditures, the tax subsidy provided to private pension plans.

The revenue loss to the Treasury from the tax breaks accorded private pensions is expected to reach $27½ billion next year. Yet, up until now, no one has taken a careful look at the extent to which that tax subsidy continues to be justified.

H.R. 6410 recognizes that this tremendous tax subsidy can only be justified to the extent that it meets the public policy objective of providing pensions to those people most in need of a supplement to Social Security. Social Security payments, even with the upcoming cost of living adjustments, will still average less than $5000 a year for a retired worker.

The Pension Equity Tax Act addresses three areas where there is almost universal agreement that this tax subsidy is not achieving the central objective of providing pensions to workers who are most in need. The first, and most important, of these areas from the perspective of the average American worker are the current Internal Revenue Service "integration" rules.

SOCIAL SECURITY INTEGRATION

While exact figures are lacking, estimates are that from 10 to 15 million workers are in pension plans that "integrate" benefits with social security. And by all indications that figure is increasing rapidly as life insurance companies and pension consulting firms escalate their efforts to sell integrated plans as a way of saving on pension "costs." Under these plans, pension costs are reduced by reducing pension benefits to low and middle income workers, via Social Security benefit "offsets" and formulas that concentrate benefits on wages in "excess" of the Social Security wage base. A Conference Board survey reports that since 1973 the percentage of plans using social security integration has gone from 40 percent to almost 66 percent.

Although pension integration is opposed by organized labor, almost all participants,[1] and even some plan consultants—one termed it a "scandalous inequity"—and was almost eliminated by Congress in 1974—H.R. 6410 does not challenge the basic concept. The bill accepts the notion that it is all right to use pensions to "even out" Social Security's "discrimination" in favor of low-paid workers by allowing employers to take credit for the employer-paid portion of social security taxes. Neither does the bill take issue with the assumption built into integrated plans that low paid workers can maintain an adequate standard of living if they receive the same percentage of pay in retirement as that received by higher paid workers.[2] The bill, instead, addresses current IRS rules that do not conform to even these concepts.

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[1] The 1979 Lou Harris "Study of American Attitudes Toward Pensions and Retirement" found that employees in pension plans were opposed to the integration of social security benefits with pensions by a margin of 60 to 35 percent.

Specifically, the bill would make it impossible for employers to take credit for more social security taxes than they have actually paid for their employees. In other words, it would eliminate windfalls to employers that have the effect of irrationally and unfairly denying benefits to their employees. It would do this by not allowing employers to offset social security benefits earned while an employee was working for an earlier employer or benefits attributable to the transfer element built into social security. For excess plans, it would reduce the percentage allowed to be contributed on wages above the Social Security wage base before contributions on wages below are required to kick-in from 7 percent to 5.4 percent, to bring this percentage more closely into line with the retirement portion of FICA. The Social Security wage base which is used as the cutoff or break-point in excess plans has risen from $17,700 in 1977 to $32,400 in 1982. Over 95 percent of the workforce now earns less than this amount. The bill would thus require all plans to conform to what is widely acknowledged by leading actuarial firms to be "good practice."

While the changes proposed by the bill would be modest, they would help a great many people. For example, it would help people who may find themselves in the position of Anna E. Smith of Columbus, Ohio. Ms. Smith recently wrote the Pension Rights Center saying:

I retired Feb. 1, 1982 from J. C. Penney Co. I had been employed there 14 years at the age of 66 . . . when I retired I had no pension.

Their statement is that: "There is no benefit payable to you from the pension plan because the Soc. Sec. retirement benefit, as estimated under the plan formula is sufficient to meet the Plan's income goal."

Now I was 10 yrs. fully vested . . . I cannot understand how they can deny me any pension even the smallest amount.

It would also help people like Betty Thomas of Austin, Minnesota. Ms. Thomas recently appeared on a television program produced by the Labor Department for public television. Her situation, described using a fictitious name, appears on page 23 of the Center's Guide to Understanding Your Pension Plan, attached to this Statement. Briefly, when a portion of her entire social security benefit was offset from her 10-year pension benefit, Ms. Thomas, like Ms. Smith, was left with no pension even though she was fully "vested" under her plan.

The lowering of the allowable percentage for excess defined contribution plans would mean a great deal to thousands, if not millions of people, who are covered by plans that give no pension benefits whatever to people earning less than a specified amount. it would almost certainly help the personnel director of a Miami hotel who called our office furious about his company's excess plan. He is 32 years old and makes $16,000 a year. No pension contributions are made on his behalf because his salary was far below the last year's $29,700 cut-off. he says that under this plan only the "top executives" are getting pensions.

A very similar complaint comes from a UPS management employee from Brooklyn, New York. He wrote:

I am a Management Employee of United Parcel Service. They have just announced an improved pension which is based on an amount of Salary with Social Security deducted. This only benefits higher Management and discriminates against about 90 percent of all Management Employees.

Despite an overwhelming private consensus among pension industry leaders that the integration objectives of H.R. 6410 make excellent sense, they are likely to oppose the changes publicly. They will say that the provisions need further consideration. They will say that the formulas are not properly targeted. They will say that plans will need to be redesigned at great expense. Or, as in 1978, they will simply lobby. One former member of this Committee is reported to have said that the lobbying on the 1978 integration proposal was more intense than on any other legislation that Session.

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[2] Every serious student of the issues has recognized that low and average income people need a greater percentage of pay from social security and pensions to maintain a decent standard of living in retirement both because they have fewer other sources of income and because they have less to cut back on. Social security integration rejects this obvious truth and accepts as a premise that all replacement rates should be equal.

The fact is that if this Committee agrees with the concept that employers should not be getting windfalls above and beyond the social security taxes they have paid, the details can be refined in cooperation with the Internal Revenue Service.

As to the administration burden argument, the bill specifically provides that no changes need be made for people who are participants in defined benefit plans before 1984, allowing plenty of time for redesign. As Lloyd S. Kaye, Vice President of the William Mercer Co., has stated, "that argument in any case is ridiculously overblown . . . it is no sweat to change a formula."

As for the barrage of lobbyists who will descend on your offices: Most will be directly or indirectly tied to consultants who have made lifetime jobs out of understanding the IRS's arcane integration and who have a tremendous stake in being allowed to continue designing and selling plans that provide large pensions and estate tax benefits to corporate officers, with few if any benefits to their other employees. They have become the "tail wagging the dog" in pension policy. As is so often true in the pension area, unless the issues are brought to the public, those who would benefit from change will in all likelihood know nothing about these proposals—and in many cases, nothing about the practice until they retire and it is too late.

PROFESSIONAL SERVICE CORPORATIONS

Nowhere has the basis for the tax break accorded private pensions—that it would encourage pensions to be paid to low and average wage earners as well as the highly compensated—been more thoroughly discarded than in the area of professional service corporations. The growing number of pension plans set up by lawyers and doctors and other professionals have become a consultant's playground providing monumental tax shelters for the actuaries and other consultants who design the plans, and little or no benefits for the lower paid employees—receptionists, clerks, typists, nurses and paralegals—who rarely if ever receive benefits from these plans.

One secretary from Jackson Heights, New York, called the Center saying that she knew that she would never get a benefit from her incorporated law firm's plan. She described her office as a "railroad," saying that "no one but the partners vest." The IRS has found that in many of these small professional plans pensions are almost exclusively a tax scam—played at the expense of lower paid employees—and the taxpayer.

H.R. 6410 recognizes that these plans—including the newer partnerships of professional service corporations which have separate plans for each partner and for their employees (described in the Washington Post article attached to this Statement) are not achieving legitimate public policy objectives. Since almost all of the professionals now incorporating had Keogh plans that provided benefits to more people than the new plans, it can be argued that the new wave of professional incorporations is but another example of paperwork entrepreneurship, running indirectly contrary to the rationale for the tax breaks provided to private pensions. These incorporations have generated only new consulting and administrative fees. There are fewer benefits for rank and file employees, and a much greater tax loss to the public.

H.R. 6410 would significantly improve professional corporation plans in which there are "owner-employees" (i.e. shareholder-employees who own more than 10 percent of the corporation). It would improve coverage (by requiring that everyone who has three years of employment be included in the plan, replacing the fair cross-section test of current law); vesting (by requiring immediate vesting after three years—an improvement over current rules allowing most plans to have 10 years cliff vesting and some smaller plans to have a maximum of 40 percent vesting after 4 years); and integration (by eliminating integration in plans where owner-employees receive substantial parts of total benefits or contributions under the plan).

The argument is being made that requiring professional service corporations to go back to Keogh plan provisions is unfair to lawyers and doctors since their counterparts in private industry can provide higher benefits for themselves. This is a kind of "leapfrog" argument that ignores the fact the Keogh plan limits are raised by this bill, and moreover, assumes that the provisions of corporate plans are themselves equitable and are achieving public policy objectives. This is open to serious question at a time when only 1 out of every 4 men over the age of 65 and 1 out of every 10 women over 65 receives income from a company or union pension plan, and when those who do receive benefits from these plans are typically higher paid, long service workers. But regardless of how good or bad job corporate plans may be doing in providing benefits to low- and middle-income workers, it is beyond dispute that the turnover among nurses and office workers in doctors' and lawyers' offices is extremely high and that, for these offices, corporate plans with long vesting and high integration levels cannot provide meaningful benefits. Moreover, doctors and lawyers are always free to go to work for a private company if the $30,000 a year—more than twice the earnings of the average worker—they are permitted to shelter under H.R. 6410 is not high enough for them.

CONTRIBUTION LIMITS

Finally, the bill proposes to cut back on what can *only* be described as excessive pension benefits—pension benefits amounting to $136,425 a year and annual contribution limits of up to $45,475 a year.

The bill poses the long-neglected question of why the average taxpayer, the factory worker, service station attendant, or secretary, must pay higher taxes to subsidize six-figure pensions for people who are in almost every instance more than able to take care of themselves in retirement through investments and personal savings. There is no evidence that employers need a pension in excess of $135,000 a year as an inducement to encourage them to "voluntarily" set up pension plans. If the promise of a $90,000 a year tax-subsidized pension does not constitute sufficient incentive, it is time for a thorough review of the entire private pension system.

No decent rationale exists to support $135,000 a year pensions. They do not benefit the average taxpayer who is not covered by a plan, or, if covered, is not likely to receive significant benefits. The scare tactic that will be used by opponents of these limitations—the possibility of plan terminations—has been used so often that it has become the Chicken Little argument of pensions. After the enactment of ERISA, the GAO's reports showed conclusively that those terminations that did occur as a result in changes in the law occurred among the worst plans—those that provided few benefits to rank and file employees. In other words, plans that terminate are usually the least efficient from the standpoint of federal tax policy in delivering benefits to the rank and file for each dollar of federal tax expenditure.

As Congressman Rangel has noted, at a time when the poor are being asked to accept cutbacks in school lunches and other vital social programs, the well-to-do can surely accept the kind of relatively minor sacrifice proposed by this legislation.

In closing, while H.R. 6410 does not come close to the complete overhaul that will be needed before the billions that private pensions cost American taxpayers become a good buy, it is a timely and extremely important first step toward making private pension plans more rational and more beneficial to millions of Americans.

Where tax breaks would go in 1983—in millions

To people—$173.4 billion, including:	*Estimated Tax Loss*
Personal Deductions and Credits:	
Mortgage interest on owner occupied homes	$25,490
State, local income, sales, personal-property taxes	21,530
Property tax on owner-occupied homes	10,635
Charitable contributions	9,315
Interest on consumer credit	7,690
Medical expenses	4,175
Deduction for two-earner married couples	3,980
Exemptions for people age 65 or over	2,370
Child and dependent care	1,475
Parent exemption for students over age 19	900
Casualty losses	850
Residential energy credits	695
Earned-income credit	550
Tax credit for the elderly	135
Political contributions	80
Income That Would Not Be Taxed:	
Company contributions to pension funds, plus earnings of plan investments	27,500,000
Company-paid medical and life insurance, other nonwage benefits	18,375
Social Security benefits	13,405
Interest on life-insurance savings	4,805
Retirement contributions of IRA and Keogh plans	3,760
Workers'-compensation benefits	3,495
Unemployment insurance benefits	2,710
Military benefits, allowances	2,255
Deferral of capital gains on home sales	1,655
Veterans' benefits	1,470

Where tax breaks would go in 1983—in millions—Continued

	Estimated tax loss
Income that would not be taxed—Continued	
Income earned abroad by U.S. citizens	$1,285
Meals furnished workers by employers	680
Captiai gains on home sales by those 55 or over	550
Public-assistance payments	430
Fellowship, scholarship income	415
Disability benefits	235
To investors, business owners, farmers: $36.1 billion, including—	
Special treatment for long-term capital gains	14,390
No tax on capital gains at death	3,975
Interest exemption on state, local bonds and debt	3,925
Investment tax credit	3,825
Exclusion for all-savers certificates	1,790
Accelerated depreciation deduction	1,695
Deduction for energy exploration, development	1,470
Excess energy-depletion allowance	1,320
Accelerated depreciation for rental housing	575
Dividend exclusion	550
Deduction for some capital outlays in farming	475
Capital-gains treatment for farming investments	455
Tax-deferred reinvestment of utility dividends	365
To corporations: $64 billion, including—	
Investment tax credit	14,825
Accelerated depreciation deduction	11,045
Interest exemption on state, local bonds and debt	8,585
Reduced rate on first $100,000 corporate income	7,125
Sales of leases	3,615
Deduction of energy development costs	3,090
Research, development deductions and credits	2,720
Special treatment of capital gains	2,330
Special treatment for corporations in world trade	2,225
Credits for firms doing business in U.S. possessions	1,285
Tax credit for employe-stock-ownership plans	1,095
Deduction for charitable contributions	1,040
Dividend deductions for cooperatives	950
Excess energy-depletion allowance	800
Credits for energy conservation, new technology	655
Excess bad-debt reserves of financial institutions	515

Note: Years end June 30 in 1973, September 30 thereafter.

[From the Washington Post, Jan. 29, 1982]

SPURRED BY TAX CODE, SUPERLAWYERS ARE RUSHING TO INCORPORATE

(By Paul Taylor)

Over at Steptoe and Johnson, the lawyers don't go around calling each other "partner" anymore. That's because they *aren't* partners anymore. As of the first of this month, the giant 170-lawyer Washington firm became a corporation.

"It's kind of regrettable," said James P. Holden, the new vice chairman of the new board of the new Steptoe and Johnson, Chartered. "All of us were quite comfortable with the term 'partner,' but we're careful now not to use it."

On Monday, it will be Hogan and Hartson's turn to change monickers. Its new letterhead is going to read: "Hogan and Hartson, a partnership including professional corporations."

A partnership including professional corporations? Steptoe and Johnson, Chartered? Can it be that the old-line Washington law firms, those bastions of civility, gentility and inertia, are really going commercial on us, after all these years?

Yes.

Holding their noses every step of the way, some of the nation's stodgiest law firms are in a full-throttle rush to incorporate. The paper change of identity either involves dissolving a partnership and re-creating it as a corporation, or retaining the partnership but allowing individual members to set themselves up as one-person corporate entities.

In both cases, the motive is the same: to take advantage of retirement provisions in the tax code that are far more generous for the incorporated than for those who are not.

Actually, the tax advantages have been around for decades, and years ago doctors and dentists—on the advice of their lawyers—started incorporating up a storm.

Even some lawyers have been incorporated for a while, but only in exotic places, like California. "They're so much more audacious out there," explains Sheldon Cohen the former Internal Revenue Service commissioner, whose local tax firm, Cohen and Uretz, began allowing individual "PCs" (professional corporations) last October.

"I guess we lawyers are sort of like the shoemaker's daughter," says John Hamilton, of Boston's Hale and Dorr, which also has gone the individual PC route. "Always the last to get a new pair of shoes. We did it for everybody else, and now we're finally getting around to doing it for ourselves."

The delay is probably more remarkable than the phenomenon, but it can be explained in a single word: tradition. Or as John S. Nolan of Miller and Chevalier, a Washington tax firm, puts it: "Lawyers are basically fuddy-duddies." They have been operating as partners forever, and they like the high-tone, collegial aura the arrangement suggests.

For years, lawyers tried to avoid the step they're taking now by getting some relief from Congress on the tax shelter disparity.

"There's no decent policy rationale for it, everyone concedes that," says Nolan, who heads the American Bar Association's taxation committee. "The simple problem is that people think lawyers make too much money already."

"As a lobby group, we aren't all that sympathetic, let's face it," adds David F. Lake Jr., of Wilmer, Cutler and Pickering, whose firm is seriously considering the PC option.

Given the generosity of spirit that swept through Capitol Hill last year as lawmakers cut taxes and added shelters, the ABA figured its moment had come. And indeed, the group made significant headway. Under the new tax laws that went into effect Jan. 1, the maximum amount of income a partner can set aside tax free in a private retirement or so-called Keogh plan doubled, from $7,500 to $15,000.

Progress, yes. But a disparity remains, and it will grow. The maximum shelter available to corporate employes is now $41,500, and that ceiling, unlike the Keogh figure that applies to partners, is indexed to rise with inflation.

The irony in the boost from $7,500 to $15,000 in the Keogh ceiling is that it will pretty much take care of the needs of your everyday lawyer from Dubuque or Des Moines, those poor benighted practitioners who are still measuring their annual income in five figures. They don't have any more than a spare $15,000 kicking around per annum to set aside for the golden years.

So it is only the superlawyers, those in the most expensive, most high-powered and, often, most tradition-bound big-city firms that still have an incentive to incorporate.

And now that their long lingering hope for full parity has been dashed, incorporating they are: New York's Cadwallader, Wickersham and Taft, Chicago's Sidley and Austin and San Francisco's Morrison Foster are among the most recent.

"It's been a chicken and egg problem until now," said Lake of Wilmer, Cutler and Pickering. "Everybody's been waiting for someone else to move first. Law firms are very concerned with appearances."

Most of the big Washington firms are expected to take the plunge this year, and as they face a starker, more commercial future, they can at least take solace from the testimony of Holden at Steptoe and Johnson, Chartered. Aside from the much lamented forced retirement of the word "partner," he reports that "the transition has been incredibly smooth."

The firm's old executive committee, which was elected, has simply been transformed into a corporate board, which is also elected. The partners are now shareholders; as before, they divide the firm's profits.

There's a bit more paperwork now; meetings have to be held and recorded and the like, officers elected, and all of this can seem awkward or excessively formal, especially when the whole corporation is just one person. But lawyers, being lawyers, will find a way.

Indeed, there can be other advantages. For example, in the partnership form, lawyers are fully liable for the malpractice of others in their firm. In corporations, they need worry only about themselves.

The inducements go on and on, but not everyone is biting. Over at Covington and Burling, Washington's biggest (220 lawyers), richest and most prestigious law firm, the whole business is being viewed with raised eyebrows.

"We're not going to do anything very fast," assures Daniel M. Gribbon, chairman of the firm's management committee, no slave to innovation he.

"We've always done things as a partnership. The only reason for changing would be tax advantage," and that, he suggests, just might not meet the burden of tampering with tradition.

[From the Washington Post, July 11, 1980]

DOCSCAM

One of the ways in which the federal government encourages saving for retirement income is by granting significant tax advantages to employers who finance pension plans for their employees. A criterion for qualifying for tax exemption is that the plan distribute benefits fairly—that there be no spectacular discrepancy between the treatment of officers of the corporation, for example, and rank-and-file workers. If a corporation were to fire employees to keep them from becoming qualified for benefits, the plan would lose its qualification and the employer's contributions would be subject to taxation. This has been the law since 1942.

Recently, a squall has blown up in this area, because a number of employers believed that a 1974 change in the pension statutes allowed them to avoid ever being subject to an investigation of how their plan operated if they adopted a standard known as "4-40 vesting," This procedure establishes that an employee attains a permanent right to receive 40 percent of his benefits after four years of employment, with additional percentages with each year of employment until 100 percent of the benefits are permanently his after 11 years. But the IRS began to note that in a number of corporations, the turnover among relatively low-wage employees was high, while the officers of the corporation stayed forever. Professional corporations—doctors', lawyers' and dentists' offices—are the prime examples. Nurses, receptionists and hygienists come and go, while the doctor is the only constant in the office. Under some plans, the effect is to lower the amount the employer has to pay in—what he contributed for one receptionist who left after two years because her husband was transferred to Milwaukee would go to finance the benefits of all the rest. Under other forms, the accrued extra value, for all those employees who didn't stay long enough to qualify, goes to raise the benefits of those who do qualify—the doctor himself. Under either form, it makes no sense. Tax benefits for these plans were established to make pensions available to the working force at large, not to provide yet another tax shelter for the already considerable income of the professional employers.

So the IRS has published a proposed regulation restating its intent to examine how pension plans actually function under the "4-40" rule, rather than taking it on faith that everything is fine. Outrage at the indignity of this IRS insult has been expressed by the professionals in the form of extreme pressure on Congress to overturn the proposed regulation even before it is published in its final form. Several bills have been introduced in the House to amend the Internal Revenue Code to keep the IRS from snooping around to see what is happening. And the panic is so great that there is some thought being given to outlawing such behavior in the Treasury appropriations bill.

We think the professional corporations protest too much. Although many are in good faith providing for their employees as well as they can manage, a number appear to have found themselves a very good deal—at the expense of the rank-and-file workers who don't get benefits and of the taxpayers who are subsidizing the whole fandango. Enough.

[From the Evening Sun, Apr. 14, 1982]

PENSION POLICY AT BG&E TO BENEFIT 2,000

(By John Fairhall)

Lee Miller, who fought for a better pension from Baltimore Gas & Electric Co., will receive $90 more a month under a company policy change benefiting all 2,000 of its retired workers.

"I am absolutely elated," said Miller, 66, of Essex. "They [BG&E] knew we weren't going to give up. And they knew they were wrong."

More than a year ago Miller's wife, Lola, prodded him into fighting a company policy they thought was unfair. The company, like many other firms, reduced a retiree's pension by a percentage of the amount he received from Social Security.

Companies defend the practice of "pension integration" on the grounds that they contribute 50 percent of their workers' Social Security taxes in addition to providing pension benefits. Federal law permits employers to reduce pension payments by up to 83 percent of a retiree's annual Social Security benefit.

Miller and his wife became experts on the issue and lobbied unsuccessfully for congressional action to end integration.

"That money is part of a worker's wages," argued Miller, for 32 years a wireman with the power company. "These companies have no right to take that money."

BG&E Chairman Bernard C. Trueschler told the retired workers in a letter April 8 that "the pension plan will be improved on June 1 . . . by eliminating the Social Security offset . . ."

"We will continue to review the effect of inflation on your total retirement income—company pension and Social Security," Trueschler said. "As justified and possible, we will make adjustments to assist you in maintaining your standard of living."

Company officials said yesterday the decision was partly a competitive one designed to keep their workers' pensions comparable to those in similar industries.

They also said the decision reflected corporate policy that over the years has reduced the offset from 50 percent of a worker's Social Security payment to 15 percent.

"This has been a bone of contention for our employees since 1940 because it has been difficult to explain to them what has happened," said Mitchell M. Hall, manager of corporate staff services.

He said the company doesn't pocket the pension money offset by Social Security. "The accrual of their pensions already discounts that Social Security," he said.

All retirees will get more, but the amounts will vary up to a maximum of about $112 a month, Hall said. Miller disputed that figure.

"One man called me and told me it's going to affect his pension by $400 a month. He's a retired executive," Miller said.

The change will cost the company $700,000 in the first year, Hall said. Although there won't be more than a "minimal" impact on ratepayers, according to one company official, Hall said it "will likely affect future wage increases."

But Miller and his wife will live a little better when their company pension check increases in June from ——— to ———. "At times like these," he said, "it's going to be a wonderful help."

LETTER RECEIVED BY THE PENSION RIGHTS CENTER FROM ANNA E. SMITH OF COLUMBUS, OHIO

APRIL 20, 1982.

To Whom It May Concern:

I'm writing in regards to my Pension. I retired Feb. 1, 1982, from J.C. Penney Co. I had been employed their 14 yrs. at the age 66.

Each year after I became 60 yrs. on my benefits statement my Pension Benefits got lower and when I retired I had no pension.

Their statement is that quote:

"There is no benefit payable to you from the pension plan because the Social Security retirement benefit, as estimated under the plan formula, is sufficient to meet the plans income goal."

Now I was 10 yrs. fully vested also in my 1979 Report they had my benefits at age 65 $3 pension, $2 profit sharing and $288. Social Security.

I never have and still do not receive 288.00 Social Security. I receive 278.40 a month. I cannot understand how they can deny me any pension even the smallest amount.

Bringing to attention the law passed on retirement a few yrs back after yrs employment. Either I'm not receiving the proper Social Security or they certainly owe me some retirement.

My 1980-1981 Annual Reports did not project what my benefits were. I received this news after retirement 2-1-82.

May I please hear from you.

Thank you

ANNA E. SMITH.

RED OWL STORES INC.,
Minneapolis, Minn., May 16, 1978.

Mrs. BETTY THOMAS,
Austin, Minn.

DEAR MRS. THOMAS: Following your request for pension information and because of anticipated changes under E.R.I.S.A., we aked that the Gamble Alden Life Insurance Company advise us of any benefits that might be available to you.

Your term of service with Red Owl has been sufficient for you to qualify for a vested pension. In determining the amount of benefit the one-half of Social Security paid for by the Company is deducted from the gross pension benefit because our plan is integrated with the federal retirement plan. In your particular computation the amount of pension benefit based on the formula is $72.72. The one-half of Social Security paid for by the Company is $99.45. Therefore, no benefit is payable to you from the Company pension plan.

If you have any questions, please let me know.

Sincerely,

CHUCK JELINEK, *Insurance.*

a
guide to
understanding
your
pension
plan

This guide was prepared by the Pension Rights Center with funds provided by the U.S. Department of Labor. Publication costs were underwritten by the Retirement Research Foundation and an anonymous grant through Joint Foundation Support, Inc.

The guide was written by Heddy F. Reid and Karen W. Ferguson and designed by Joy Halsted.

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IMPORTANT: In this guide, discussion is limited to the most common kinds of pension plans. These are company and union plans designed to pay a specified amount of money every month throughout your retirement.

This guide does not discuss government pension plans. Nor does it cover other kinds of pension plans, such as profit sharing, thrift, and money purchase plans which base benefits on amounts contributed to the plan plus interest and increases in value. Also, the guide does not discuss disability or other benefits payable before retirement age.

Pension plans are required by law only to contain certain minimum provisions. Pension plans can, and often do, have better provisions than the minimums discussed here.

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few documents

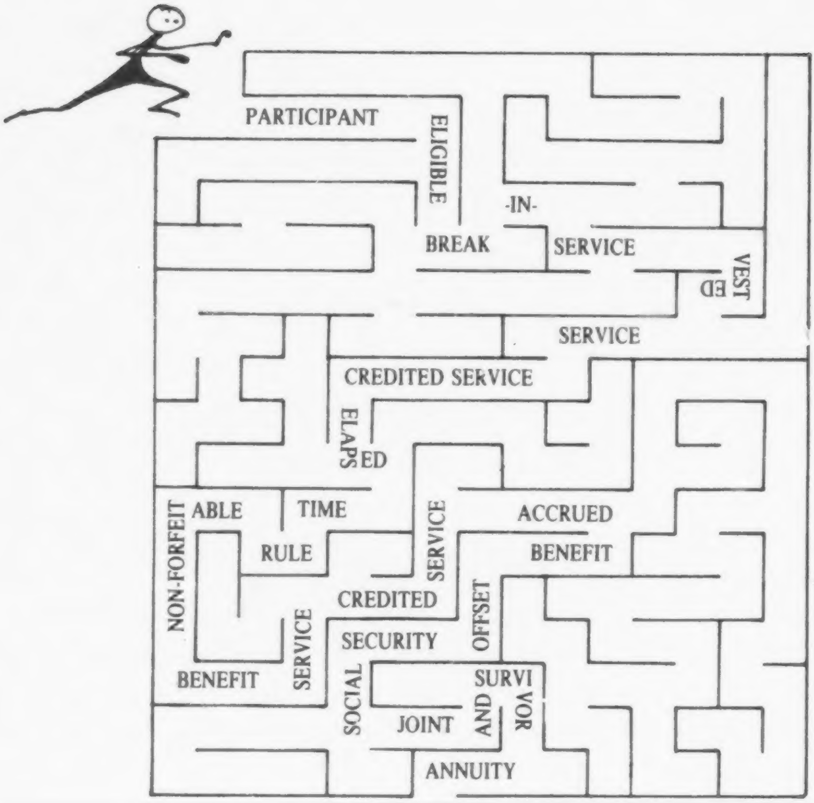
are as important as your pension plan, yet many people do not fully understand their plans.

This booklet is a guide, written to explain *why* you should take the time to understand your pension plan and *what* you should look for in reading your plan and plan booklet.

We suggest that you first read the larger print sections of the guide through quickly. This should take only a few minutes, and will give you an overview of how your pension plan works. Then go back over the guide, reading each section carefully.

After you finish reading the guide you should look at your own plan's information, turning back to the guide for help in understanding any confusing parts of your own plan. Do not hesitate to ask your company or union for this information if you do not already have it.

Because pension plans are so different, there may be things in your plan that are unlike points in the guide, but the overall picture is likely to be much the same.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your pension plan

1

Why pensions are important

At retirement many people find that their income is greatly reduced. Often this is because their only income is the money they receive from social security. Social security by itself was never intended to provide an adequate retirement income. While other money can come from savings or investments, relatively few people have enough savings or investments to provide them with an adequate lifetime income. Unless you are one of the fortunate few, a pension is going to make a critical difference in how you will live in retirement.

How pension plans work

Over the years, companies that offer pension plans put money into a pension fund. The money is invested, and is used to pay monthly pension benefits to retired workers who meet certain requirements. Most often, these requirements have to do with how long you work, whether you work continuously, and how much you earn.

Where to find out about your pension plan

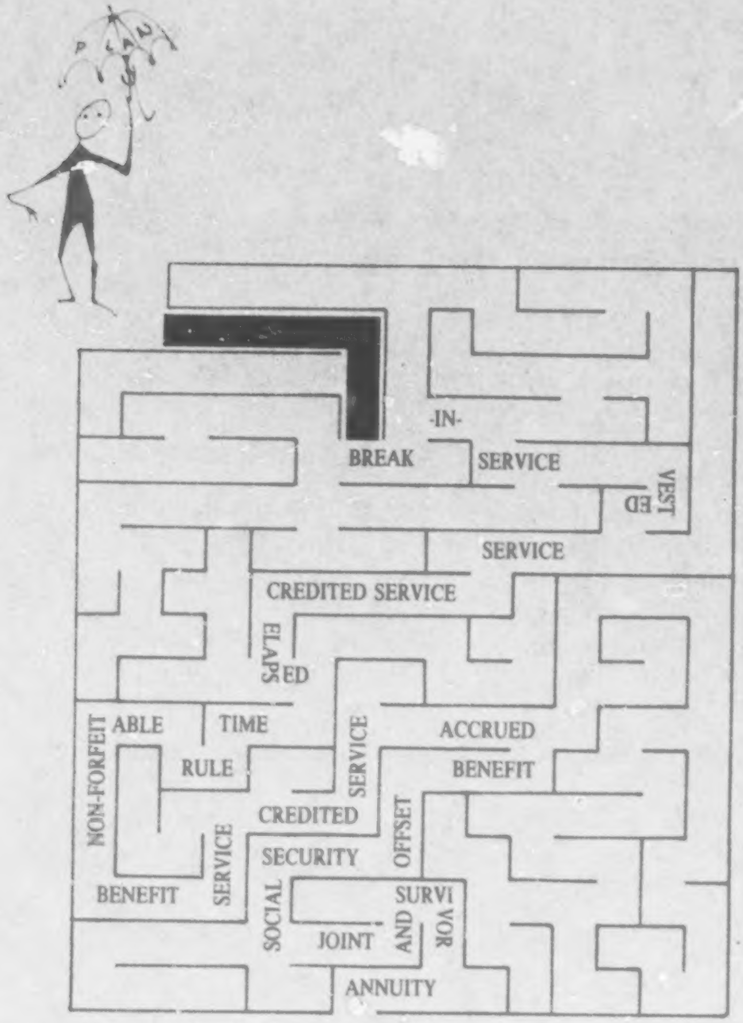
The requirements you have to meet to get a benefit from the pension plan are set forth in a legal document. Since this legal pension plan document is often hard to understand, companies with pension plans are required by law to give you a summary of your plan. Most commonly, this summary is in booklet form.

It is very important for you to read your plan's booklet, often called the *summary plan description.* Unless you know what your pension plan can and cannot do for you, you may be disappointed as you near retirement. You could find that you do not have the right to receive the pension benefits you expected.

This guide will help you through the pension maze. It will tell you what to look for in reading your plan's booklet and will explain special pension words and phrases that might otherwise seem unfamiliar. It will help you find out:

- If you are covered by a pension plan.
- Whether you have the right to receive a pension.
- How much your pension benefits will be.

IMPORTANT: Many plan booklets include a statement that says that if there is a difference between the information in the booklet and the legal pension plan document, the plan document itself, not the booklet, has the last word. If your booklet contains this kind of statement, you should ask for a copy of the plan document and read it along with the booklet.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2

are you covered by your plan?

The first thing you need to know is whether your company pays into a pension plan. It may not. Companies are not required to have pension plans.

If you work for a company, or a union, that has a pension plan, you need to know whether you are a member of the plan. It is possible that your job may not be covered by the plan.

Generally speaking, if the kind of work you do is covered, you become a member of the plan:

- when you turn age 25 or have worked a year, whichever comes later, *and*
- if you regularly work 1,000 hours a year—this is about equal to working 20 hours a week for a full year, or 40 hours a week for 6 months.

IMPORTANT: The plan may not include you if you were close to retirement age when you were hired.

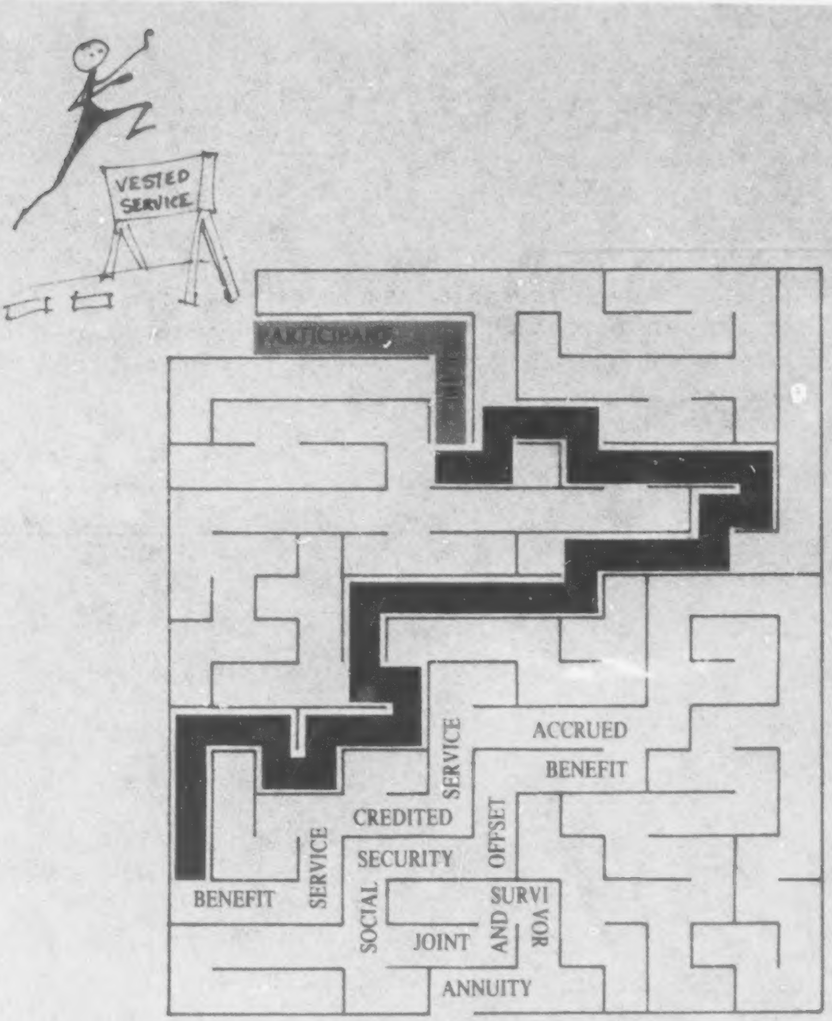
Key words that may help you to know whether you are covered by your pension plan are **participant** and **eligible.** Your booklet may say you are a **participant** in the plan if you have reached a particular age and work in certain jobs for a specified number of hours. This means you are included in the plan.

Participation in a plan is a necessary first step towards earning retirement benefits. It means you are covered by the plan, **but it does not mean that you can count on collecting a pension from that plan.**

The other key word, **eligible,** does not necessarily mean you are eligible to receive benefits from the plan. It may only mean that you are eligible to be a **participant** in the plan.

FOR EXAMPLE, Larry Otis started work as a clerk typist for the Pratt Company at age 18. His plan booklet said he would be eligible to become a participant in the pension plan when he reached age 25. He assumed that meant if he was still with the company when he reached age 25, he could count on receiving a pension at retirement age.

When he left the company at age 26, Larry Otis was surprised to find out that the fact that he was a participant in the plan was not enough to give him the right to receive a pension later. He had not realized that to get a pension he also needed to meet other plan requirements.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JOINT AND SURVIVOR ANNUITY
BENEFIT SERVICE

will you receive a pension?

3

When you are sure you are covered by a plan, you need to know what you have to do to receive a pension at retirement.

First, you must know the number of years your plan says you have to work before you can get pension benefits at retirement age. **Most plans require that you work 10 years before you earn a right to a pension.**

Second, you need to know whether all of the years you work will actually be counted under the plan.

Key words that may help you know whether your years will count are **vested service** and **credited service**.

Vested service simply means the years your plan takes into account in determining whether you have worked long enough to earn the right to receive a pension.

Credited service is more complicated. It can mean the same thing as vested service, or it can mean service that is used in figuring how much money you will get at retirement. If your booklet is not clear in the way it uses these terms, you should ask the person in charge of your pension plan for an explanation.

Different plans have different ways of deciding whether your work years count toward your right to a pension. Usually you get credit for a year if you work a certain number of hours during that year.

A typical plan will say that a year will be counted toward your right to a pension if you have worked at least 1,000 hours in that year. Most plans start counting a year on January 1st, but that is not always the case.

IMPORTANT: If you work part-time don't miss getting a pension because you work just under 1,000 hours a year. For example, if you work 19 hours a week and could work 20, that extra hour a week could make a difference in your getting a pension.

Some plans use a different rule to figure out whether you have worked long enough to earn a right to a pension. This other rule is called the *elapsed time rule*. A plan using the elapsed time rule ordinarily starts counting a year from a date that corresponds to the day you were hired rather than January 1st. It gives you credit only if you are employed throughout a particular year from the first to the last day of that year.

In determining whether you have earned a right to a pension, plans generally are required to count work years after age 22 (even if you did not become a member of the plan until age 25).

Plans are not required to count:

- Years you worked before your company started contributing to the pension plan.
- Years you worked before specified breaks in service.

Breaks in service can result in the loss of your earlier years of credit. You may lose credit if a break occurred before 1976. You may also lose credit for earlier years if you are away from work for long periods. This will happen if your time away from the job is as long or longer than the total time you worked before the break.

FOR EXAMPLE, Kate Miller had been working for the Rutledge Manufacturing Co. for 3 years. When her first child was born, she decided to stop work, and did not return until the child was 4 years old. Since Ms. Miller was away from work 4 years, and had only worked 3 years before her break in service, she lost the pension credit she had earned for those first 3 years with Rutledge. If she had returned to work after 2 years, she would have kept the credit for the years she worked before her child was born.

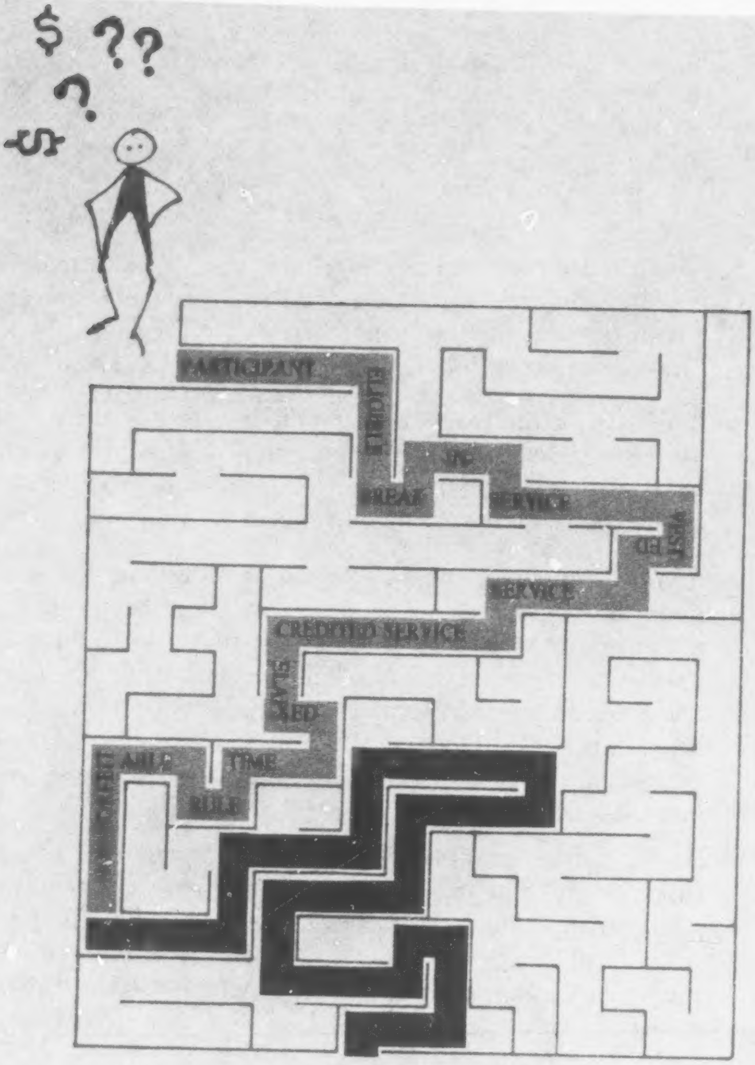
You should know that periods of military service in time of war are not considered to be breaks in service and will count toward your right to a pension if you come back to the same job.

Once you have worked long enough to get a right to a pension, you don't have to worry about breaks in service.

In pension language, there are times when words don't always mean what they seem to. Two of the more troublesome words are **vested** and **nonforfeitable.** When you have worked long enough to earn a legal right to a pension, you may be told that you have a vested right to your pension. But being vested does not necessarily mean that your pension is yours to collect right away. Vested means only that some pension benefits will be yours **when you reach retirement age**—even if you leave the company before then.

Some plans use the word **nonforfeitable** instead of vested. Generally, they both mean the same thing. But neither means that your pension can never be taken away. There are circumstances where people can lose nonforfeitable benefits.

- If you die before reaching a certain age, usually early retirement age, your benefits may be forfeited. This means that your husband or wife will not receive any pension benefits from your plan.
- If your company or union's pension plan gets into serious financial trouble or ends without enough money in the pension fund to pay all promised benefits, you could lose part or all of your pension. Plans paying specified benefits are insured by a federal government agency, but not all benefits provided by those pension plans are insured. You should check your booklet to find out if your benefits are insured.
- If you go back to work for the same company or, in some cases, in the same industry, after you retire, your pension payments may be temporarily suspended. Ordinarily the suspension is only for the period you are working but in the case of some early retirement benefits the suspension may be for a longer period.
- If you go to work for a competitor, you should know that a few plans have provisions that can cause you to lose certain vested benefits.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how much will your pension be?

4

Once you are sure you will receive a pension at retirement, you will want to know how much you will get. To start figuring out the amount of your pension you will need to know how many years you have been covered by the plan. These are the years that will be counted toward the amount of your pension. These may not be the same years you need to earn the right to a pension.

FOR EXAMPLE, Maria Gonzalez worked for General Grocery Stores for 10 years, from ages 22 to 32. When she was 32, General told her that she had the 10 years she needed to earn the right to receive a pension at retirement age. However, the amount of her pension would only be based on the years she had been covered by the plan, that is, those years she had worked after turning age 25 (7 years).

IMPORTANT: Plans do not have to count the years you work after age 65 toward the amount of your pension. They do, however, have to count certain years of military service. Also, a few plans require that you work 2 continuous years before they begin to count those and your later years in figuring the amount of your pension.

Some plans count years worked before you were covered by the plan. These may be years before your plan started or before your company began contributing to a plan.

IMPORTANT: If your plan gives credit for years worked before you were covered by the plan, be sure that this **past service credit** applies to all pension benefits, not just to special benefits for people who work long periods under the plan. Also, if your plan was negotiated by a union with more than one company, check to find out if the past service pension credit will be lost if your company later withdraws from the plan.

Key words that may help you figure out which years count toward your pension are **benefit service** and **credited service.**

Benefit service generally means the years your plan counts in computing the dollar amount of your benefit. **Credited service** can mean the same thing, but since it can also mean the time that counts for vesting, **check carefully to see how this phrase is used in your plan.**

Once you know what years count in figuring the amount of your benefit, you need to know how your plan calculates your benefits.

In pension language, the total amount you have earned is often called the **accrued benefit.** Keep in mind that although your plan will ordinarily accrue a benefit for every year that you have been a member, you do not have a right to the accrued benefit until you are vested. At that point, you will have an **accrued vested benefit.**

The most common formula for figuring the amount of your pension benefit multiplies a percentage of your pay by the number of years that you have been covered by the plan. Most plans average your earnings over a period of time to calculate your pay for this purpose.

FOR EXAMPLE, for each year you have been covered, your plan might give you a benefit of 1½ percent of your average earnings over your last 5 years of work multiplied by the total number of years you were covered. If your average earnings are $10,000, and you have worked 10 years under the plan, your pension would be $10,000 × 1½% × 10 years = $1,500 a year, or $125 a month.

Another method for figuring the amount of your benefit gives you a flat dollar amount for each year that you have been covered by the plan.

FOR EXAMPLE, your plan might give you $12.50 a month for each year that you have been covered by the plan. If you have worked 10 years under the plan, your pension would be figured as $12.50 × 10 years = $125 a month, or $1,500 a year.

IMPORTANT: Some plans consider years worked before 1976 to be worth only half as much as more recent years, and most give only partial benefit credit for years in which you work less than full-time. Also, many plans give more weight to the later years of work than to the earlier years.

For example, each of your first 10 years may be worth $10 a month, the next 10 years worth $11 and the 21st through 40th years worth $12 each.

10 years × $10 = $100
10 years × $11 = $110
20 years × $12 = $240
Your pension = $450 a month or $5,400 a year

Since employees who stay with the company the longest do the best under this kind of plan, you may want to think about the way your pension plan is figured before considering a job change.

There are other important factors that can affect the amount of your pension. These include whether your plan takes social security benefits into account in figuring the amount of your pension, your marital status, and the age at which you start receiving benefits.

Because employers also contribute to your social security, some pension plans use formulas that take into account the amount of your social security benefit in calculating your pension benefit. This is called *integration* with social security. One form of integration is known as a *social security offset.*

FOR EXAMPLE, when Dave Johnson left the Bluebird Company after 10 years of work, the company told him that although he qualified for a vested pension of $72 a month, he would get no pension at all. This is because the pension plan subtracted $99, one-half of his social security benefits, from his $72 pension benefit, leaving him without any pension. Mr. Johnson's only retirement income is the $198 he receives each month from social security.

Not all offsets have such a drastic effect. Most leave at least some pension benefits in addition to social security. However, this is an example of a real situation and points to the need to check carefully if your plan uses a social security offset.

Your plan may use a different form of integration. It may give pension credit only for earnings above a certain amount.

FOR EXAMPLE, Tanya Barker worked in the Rainbow Cafeteria for 20 years. When she retired she was averaging $11,000 a year. Her pension plan provided a yearly pension equal to 1% of final average earnings **above** $10,000 multiplied by her years under the plan. Ms. Barker's pension was figured: $1,000 ($11,000 − $10,000) × 1% × 20 years, giving her $200 a year, or $16.60 a month to add to her social security benefits.

If you are married when you are ready to collect your pension, your benefit will automatically be provided in the form of a *joint and survivor annuity.* This means that if you die, your widow or widower will get a benefit for life. If you do *not* want this protection you must sign a statement saying you do not want your widow or widower to get a benefit. If you accept the protection, the benefit will be scheduled to be paid over two lifetimes, and may be reduced depending on your age and the age of your husband or wife. Ask the person who runs your plan how much your pension would be reduced, and how much your widow or widower can expect to receive if you die. Usually a surviving spouse benefit is equal to one-half of your reduced benefit.

IMPORTANT: Most plans do not provide lifetime monthly benefits for the widows and widowers of workers who die before their plan's early retirement age. Even if you die after early retirement age, your wife or husband could still be left without benefits under certain circumstances. Read your survivor's benefits provisions carefully.

If you are married, you should know that some states consider pensions to be joint property belong-ing to both husband and wife. If you divorce in one of these states, a court may award a share of the pension earned during your marriage to your former husband or wife.

Pension plans ordinarily begin paying full retirement benefits at age 65, the *normal retirement age* of most plans.

Many people do not keep working until they reach age 65. People retire early because of poor health, because they are laid off, or just because they want to try something new.

Your pension at early retirement age is likely to be much smaller than it would be if you continued to work until 65. This is because the pension is paid for the rest of your life. If you retire early, the pension is likely to be paid to you over a longer time.

The exact amount of the early retirement reduction varies from plan to plan. Under a typical plan, your benefits will be reduced by approximately 33% if you retire at age 60 and by 50% if you retire at age 55.

FOR EXAMPLE, when Greg Stefanic decided at age 55 to leave his job at the Stover Shoe Factory, he considered applying for his pension. That pension was based on the formula $16,000 salary × 2% × 30 years, which at age 65 would yield a pension of $9,600 a year.

When Mr. Stefanic found out that his pension would be reduced by 50 percent to $4,800 a year if he applied for his pension at age 55, he decided to get a job somewhere else and wait until age 65 before applying for his pension from Stover.

IMPORTANT: Some plans provide much larger, special benefits to long service employees who continue working under the plan until a particular age. For example, certain plans provide special benefits to people who continue working until age 57 and have 20 years of service. To qualify for one of these larger benefits, however, you have to be working under the plan at the time you reach the specified age. If you are working somewhere else when you reach that age, or are unemployed, you will not receive the special benefits—even though you may have the required number of years.

Finally, you should know that the amount of your pension benefit is usually fixed the day you stop working under the plan. While some plans increase benefits from time to time for retirees, most plans do not. Pension plans, unlike social security, ordinarily do not provide cost-of-living increases.

Now that you have an idea of how pension plans work, it is very important for you to look closely at your own plan. While this guide can help you understand your pension plan, you should realize there are many points not covered here. If there are things you don't understand, don't hesitate to ask for help. Under the Employee Retirement Income Security Act (ERISA), you have the right to be informed about your pension plan.

Your pension plan booklet will tell you who to contact for information. If you have difficulty getting information from this person, usually called the *plan administrator*, you should contact the Area Office of the U.S. Department of Labor, Labor-Management Services Administration nearest you.

U.S. DEPARTMENT OF LABOR

LABOR-MANAGEMENT SERVICES ADMINISTRATION

AREA OFFICES

ATLANTA, GA 30367
1365 Peachtree St., N.E.
Tel: 404-881-4090

BOSTON, MA 02108
110 Tremont St.
Tel: 617-223-6736

BUFFALO, NY 14202
111 W. Huron St.
Tel: 716-846-4861

CHICAGO, IL 60604
175 West Jackson Boulevard
Tel: 312-353-7264

CLEVELAND, OH 44199
1240 E. Ninth St.
Tel: 216-522-3855

DALLAS, TX 75202
Griffin and Young Streets
Tel: 214-767-6831

DENVER, CO 80294
1961 Stout St.
Tel: 303-837-5061

DETROIT, MI 48226
231 W. Lafayette St.
Tel: 313-226-6200

EAST ORANGE, NJ 07018
576 Central Avenue
Tel: 201-645-3712

HATO REY, PR 00918
Carlos Chardon St.
Tel: 809-753-4441

HONOLULU, HI 96850
300 Ala Moana
Tel: 808-546-8984

KANSAS CITY, MO 64106
911 Walnut St.
Tel: 816-374-5261

LOS ANGELES, CA 90012
300 N. Los Angeles St.
Tel: 213-688-4975

MIAMI, FL 33169
111 N.W. 183rd St.
Tel: 305-350-4611

MINNEAPOLIS, MN 55403
100 North Sixth St.
Tel: 612-725-2292

NASHVILLE, TN 37203
1808 West End Bldg.
Tel: 615-251-5906

NEW ORLEANS, LA 70130
600 South St.
Tel: 504-589-6173

NEW YORK, NY 10278
26 Federal Plaza
Tel: 212-264-4830

PHILADELPHIA, PA 19106
601 Market St.
Tel: 215-597-4961

PITTSBURGH, PA 15222
1000 Liberty Ave.
Tel: 412-644-2925

ST. LOUIS, MO 63101
210 Tucker Blvd.
Tel: 314-425-4691

SAN FRANCISCO, CA 94105
211 Main Street
Tel: 415-556-2030

SEATTLE, WA 98174
909 First Avenue
Tel: 206-442-5216

WASHINGTON, DC 20006
1730 K Street, N.W.
Tel: 202-254-6510

If you would like information about your rights under the federal private pension law, ERISA, the Employee Retirement Income Security Act of 1974, write to:

U.S. DEPARTMENT OF LABOR
Pension and Welfare Benefit Programs
Office of Communications
200 Constitution Avenue, NW, Room N4662
Washington, DC 20216 (202) 523-8764

For a determination of whether a private pension plan meets minimum government requirements, contact the Internal Revenue Service District Director listed in your phone book or contact:

INTERNAL REVENUE SERVICE
Employee Plans Division
1111 Constitution Avenue, NW, Washington, DC 20224
(202) 566-6740

If your pension plan terminates or is about to terminate, you should direct your questions regarding payment of benefits to the PBGC:

PENSION BENEFIT GUARANTY CORPORATION
2020 K Street, NW, Washington, DC 20006 (202) 254-4817

PENSION RIGHTS CENTER PUBLICATIONS

Pension Facts 1: Myths and facts about the private pension law. $.50

Pension Facts 2: Women and the private pension law. $.50

Women & Pensions: A quarterly newsletter summarizing recent developments affecting women. $2.00

Retirement Income: A newsmagazine with articles by nationally known figures on pensions and social security. $1.00

A Guide to Understanding Your Pension Plan: What people should look for in reading their pension plans. $2.00

THE PENSION RIGHTS CENTER is a nonprofit group organized to educate the public about pension issues, protect the pension rights of workers, retirees and their families and develop solutions to the nation's retirement income problems. The Center's goal is a retirement income system that is fair, adequate and responsive to the needs of individuals and the economy.

PENSION RIGHTS CENTER
1346 Connecticut Avenue NW Washington DC 20036

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Mr. **Rangel.** Ms. Flowers.

STATEMENT OF WANDA FLOWERS, STAFF COUNSEL, WORKING WOMEN EDUCATION FUND

Ms. **Flowers.** Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you to speak on behalf of the Working Women Education Fund, which conducts educational activities for 9 to 5 National Association of Working Women.

9 to 5 has associates in 10 cities throughout the country and members in every State. The Working Women Education Fund and 9 to 5 endorse H.R. 6410 because it will eliminate some of the inequities experienced by women. In the interest of time, I will simply highlight some of the aspects of my testimony.

Mr. **Rangel.** Without objection, the full statement will appear in the record.

Ms. **Flowers.** Today, for the first time in history, more adult women are workers than homemakers; 44 million are working, more than ever before. Fourteen million of these women are 45 years and older. One-third are clerical workers.

Little serious attention has focused on the plight of older women workers, despite the fact that this group encounters severe barriers when looking for a job, is often the victim of discrimination on the basis of both sex and age when employed, and makes up the great bulk of the retired poor. And little organized effort has been exerted by older women workers to protect themselves through stronger laws and public policies.

Social security, pension benefits, and personal savings are the major sources of income for retired working people. The average single woman retires with less than $1,000 in the bank. As inflation eats away at these already inadequate savings, it is clear that significant reform of pension systems is crucial.

Who receives a pension? A small minority of working people. And within that minority, women are an even smaller minority.

About 12 percent of women in private industry receive a pension—averaging $1,350 per year. Twenty-one percent of men in private industry receive a pension, averaging $1,830 per year.

Another problem with pensions is vesting. Most plans today require an employee to work for a single company for 10 years before she or he becomes vested—that is, eligible to collect the benefits.

Such slow vesting is perhaps the most glaring inequity of the private pension system. It is totally unrealistic for the vast majority of working women—as well as working men.

Women's average tenure at a particular job is 2.6 years, compared to 4.5 years for men. And while older women tend to remain at a job for longer than younger women, for women age 45–54, the median job tenure is only 5.9 years—not long enough to vest. For women age 55–64, the average is 8.5 years, and for women age 65 and older, the average drops to 8.4 years.

Typical of the nonunion, low-pay industries where women predominate is the "integrated" pension plan. In this kind of plan, the employer subtracts part of the employee's social security earnings from the accrued pension benefits to arrive at the retiree's monthly pension payment. For example, an employer might subtract half of the employee's social security benefit.

Because social security is a progressive system—that is, it pays a greater percentage to those with lower incomes—integration takes away a greater percentage from those with lower incomes.

Another form of integration allows employers to pay into the pension plan only on a certain part of the employee's income. For example, it is common for employers to contribute only on that part of the employee's salary that is above $10,000. The average woman's salary is $9,360. In the average bank, for example, this kind of integrated plan would exclude most women employees.

As women approach retirement they are wracked with worry. The following typical remarks indicate the need for massive pension reform:

> After working for 22 years for a publishing company where I worked my way up from stenographer to administrative secretary, I get a pension check of $55 in the mail every month.

Joan Brown, who has worked for 9 years for a company that plans to leave town in September, may or may not get in her 10 years before the company leaves her behind.

> Even if I do make it to 10 years, my pension will be about $180 a month. My pension might be enough to pay the taxes on my house, not much more. And to top it off, our company has an integrated pension plan, so when social security is increased by 14 percent, my pension will go down 6 percent.

Another person says,

> My pension will amount to almost nothing. What will I do when I retire? I'll probably have to go on welfare—I don't have a husband or children to support me.

Older women make up 70 percent of all poor people over 65. They have the lowest median income of any wage or sex group and they are the fastest growing segment of the Nation's poor. The average single woman retires with less than $1,000 in personal savings. Social security payments average only $233 per month for a single woman, and this is 85 percent of the total income for the majority of elderly women.

Pension benefits average just $157 for those lucky enough to receive them. Ninety percent of women in private industry do not receive a penny of pension benefits.

Working women would like to commend this committee for examining this issue. Obviously you recognize the fact that most plans are unfair. The integrated pension plan and the plans instituted by professional service corporations do not adequately provide for nonunion low-paid clerical workers, yet more is needed and we would like to ask for greater reform and to provide universal pension coverage, that there be required immediate vesting so that employees would accrue pension benefits for all the years they work, that prorate pension coverage for part-time workers and that integrated plans be abolished all together against low-paid women and minority employees.

In this time with a critical economy before us, we cannot afford the effects of discrimination against older Americans. Now more than ever, the United States elderly citizens need the Government's unwavering commitment to fair pension laws.

Thank you.

[The prepared statement follows:]

Statement of Wanda Flowers, Legal Counsel, Working Women Education Fund

Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you today to speak on behalf of the Working Women Education Fund to express the concerns of office workers about the existing pension laws.

Today, for the first time in history, more adult women are workers than homemakers. Forty-four million are working, more than ever before. Fourteen million of these women are forty-five (45) yuears and older. One third are clerical workers.

Little serious attention has focused on the plight of older women workers, despite the fact that this group encounters severe barriers when looking for a job, is often the victim of discrimination on the basis of both sex and age when employed, and makes up the great bulk of the retired poor. And little organized effort has been exerted by older women workers to protect themselves through stronger laws and public policies.

When women retire, they enter the world of poverty. For, women 65 and older are the fastest-growing poverty group in America today. And they have the lowest average income of any age or sex group.

The majority of people over 65 are women, and the percentage increases with age: 59 percent of all people over 65 are women; 62 percent of all people over 75 are women.

Unmarried women have particularly urgent needs; 72 percent of poor people over 65 are unmarried women. The poverty rate for older women is 60 percent higher than for younger women.

Thirty-six percent of the black aged were poor in 1977, and the differential between white and black elderly income increased between 1966 and 1977. With 2 million women 65 and older living in poverty--including 40 percent of minority women 65 and older—the issue of women and poverty demands attention.

As Dr. Arthur Fleming stated to the Federal Council on Aging in 1975:

"The interrelationship and long-term continuation of many discriminations in opportunities for employment, for training, job advancement and credit, inequities of salary, pension and benefit levels—all have conspired to bring poverty and financial insecurity to the overwhelming majority of older women."

The wage discrimination that plagues women and minorities throughout their careers has a devastating impact on their retirement incomes. And the retirement income systems themselves have a discriminatory effect on women and minorities.

Social security, pension benefits and personal savings are the major sources of income for retired working people. The average single woman retires with less than $1,000 in the bank. As inflation eats away at these already inadequate savings, it is clear that significant reform of pension systems is crucial.

Historically, pensions were seen as special rewards reserved for only the most loyal, long-term employees. The 1974 Employment Retirement Income Security Act (ERISA), which reformed pension laws, reflected the beginning of a change in attitude toward pensions. More and more, there is pressure for employers to accept the responsibility of providing for all employees during retirement years.

Despite ERISA, however, a combination of factors—requirements, integrated plans, and women's segregation into industries without pension coverage—have excluded the majority of working women from any pension coverage, and has severely limited the value of the pensions received by those women who do qualify. Pensions reflect one more way in which women's work remains undervalued, and women themselves remain second class citizens.

COVERAGE

Who receives a pension? A small minority of working people. And within that minority, women are an even smaller minority.

About 12 percent of women in private industry receive a pension—averaging $1,350/year. Twenty-one percent of men in private industry receive a pension, averaging $1,830/year.

About 50 percent of all working wmen are in jobs with no pension plans. Women are concentrated in the sales and service industries, which have the fewest pension plans. These jobs are the lowest paying in the country, and saving for retirement is therefore difficult.

A 1972 survey showed that 49 percent of men and 21 percent of women had private pension coverage on their longest jobs. But only 35 percent of men and 13 percent of women actually received any pension benefits that year. Only 2 percent of widows receive their husbands' pension benefits.

The ERISA law in 1974 corrected some of the inequities of the past. But because ERISA was not retroactive, the effects of those past inequities are still with us today.

For example, in the past a woman could lose all her accrued benefits if she left the workforce to have children. Today, if her time away from the job is shorter than the time she worked before her break in service, she retains her pension benefits. But many women are currently suffering the effects of losing their accrued benefits under the old law.

Before ERISA, plans were allowed to exclude workers who began work over the age of 45. Many women returning to the workforce after raising children were penalized. Since this provision was not retroactive, a woman who went to work in 1960 at the age of 46 lost 16 years of pension credits. By the time she retires she will not have worked the 10 years required in a single company usually necessary to vest. Thus she will earn not a penny of pension benefits.

The new law itself permits plans to begin covering employees at age 22, and to dicount years worked before then. Women who begin at 18, marry, and leave work temporarily to have children are directly penalized. While employees may leave their jobs for military duty with no loss of accrued pension benefits, there is no such provision for mothers. Further, the law permits employers not to pay any pension benefits to workers age 65 to 70.

As for part-time workers—of whom 8 million are women—the law requires only those who work 19.2 hours per week, or fulltime for 6 months in a year, to be covered in a pension plan.

Women's right to receive pension benefits upon the death or divorce of their spouse is also limited. Divorced women have no legal claim on their husbands' pensions. And widows' benefits must be granted only if the marriage is intact for at least one year before the husband dies. Under most plans, a widow receives no benefits if her spouse dies before retirement age.

The current law permits an employee to make a unilateral decision to sign away survivors' benefits in favor of larger benefits during the employee's own lifetime as a retiree. The result is that a woman who assumes that she will collect her husband's pension payments after his death may be rudely surprised to find she is left with nothing. Most women do outlive their husbands by 11 years. The law needs to be changed to require the consent of both spouses in choosing to waive survivors' benefits.

VESTING

Most plans today require an employee to work for a single company for 10 years before she or he becomes vested—i.e. eligible to collect the benefits. Such slow vesting is perhaps the most glaring inequity of the private pension system. It is totally unrealistic for the vast majority of working women—as well as working men.

Women's average tenure at a particular job is 2.6 years, compared to 4.5 years for men. And while older women tend to remain at a job for longer than younger women, for women age 45–54, the median job tenure is only 5.9 years—not long enough to vest. For women age 55–64, the average is 8.5 years, and for women age 65 and older, the average drops to 8.4 years.

Why do women fail to remain at jobs for the ten years required to vest? Women's careers, while lasting several decades, are generally interrupted by child-bearing and child-rearing responsibilities. Women are far more likely than men to interrupt their careers to care for ailing or elderly family members.

So it is that millions of women do not receive a penny of pension benefits after a lifetime of work. Ironically, a recent study published by the Employee Benefit Research Institute (entitled Preliminary Analysis of Alternative Vesting Requirements) indicates that the average annual increase in contributions that would be required for a plan to shift from 10-year vesting to full vesting is only 2.5 percent. This small output would make a significant difference in the security of millions of people, both men and women.

INTEGRATED PENSION PLANS

Typcial of the non-union, low-pay industries where women predominate is the "integrated" pension plan. In this kind of plan, the employer subtracts part of the employee's social security earnings from the accrued pension benefits to arrive at the retiree's monthly pension payment. For example, an employer might subtract half of the employee's social security benefit. Because social security is a progressive system—i.e., it pays a greater percentage to those with lower incomes—integration takes away a greater percentage from those with lower incomes.

Another form of integration allows employers to pay into the pension plan only on a certain part of the employee's income. For example, it is common for employers to contribute only on that part of the employee's salary that is above $10,000. The average woman's salary is $9,360. In the average bank, for example, this kind of integrated plan would exclude most women employees.

INADEQUATE PENSION EARNINGS

As women approach retirement they are wracked with worry. The following typical remarks indicate the need for massive pension reform:

"After working for 22 years for a publishing company where I worked my way up from stenographer to administrative secretary, I get a pension check of $55.00 in the mail every month."

Joan Brown, who has worked for 9 years for a company that plans to leave town in September, may or may not get in her ten years before the company leaves her behind. "Even if I do make it to ten years, my pension will be about $180.00 a month. My pension might be enough to pay the taxes on my house, not much more. And to top it off, our company has an integrated pension plan, so when social security is increased by 14 percent, my pension will go down 6 percent."

"My pension will amount to almost nothing. What will I do when I retire? I'll probably have to go on welfare—I don't have a husband or children to support me."

Older women make up 70 percent of all poor people over 65. They have the lowest median income of any wage or sex group and they are the fastest growing segment of the nation's poor. The average single woman retires with less than $1,000 in personal savings. Social security payments average only $233 per month for a single woman, and this is 85 percent of the total income for the majority of elderly women. Pension benefits average just $157 for those lucky enough to receive them. Ninety percent of women in private industry do not receive a penny of pension benefits.

RECOMMENDATIONS

Employers and Congress must act to improve the treatment of older people after retirement.

EMPLOYERS

Employers should: Institute pension coverage for all employees with immediate vesting; and improve the quality of pension benefits by eliminating the integrated pension plan.

CONGRESS

I would like to commend this committee for examining the issue. Obviously, you recognize the fact that most plans are unfair. The integrated pension plan and the plans instituted by professional service corporations do not adequately provide for non-union, low-paid clerical workers. Yet more is needed.

Pension reform should:

Provide universal pension coverage; require immediate vesting, so that employees would accrue pension benefits for all the years they work; pro-rate pension coverage for parttime workers; abolish integrated plans that discriminate against low-paid women and minority employees; require pension credits to be shared by both spouses in the event of divorce; require an employee's spouse to consent to the waiving of survivors' benefits; preserve pension credits during breaks in service; and require cost-of-living raises for pension plans.

In this time, this critical economy, we cannot afford the effects of discrimination against older Americans. Now more than ever the United States' elderly citizens need the government's unwaivering commitment to fair pension laws.

Mr. RANGEL. The Small Business Council is not with us?

STATEMENT OF CONVERSE MURDOCH, VICE PRESIDENT, SMALL BUSINESS COUNCIL OF AMERICA, INC., ON BEHALF OF MORTON A. HARRIS, PRESIDENT

Mr. **Murdoch.** I am Converse Murdoch. Morton Harris was here Tuesday, but he could not return. I am the vice president of the Small Business Council, and I am appearing in lieu of Mr. Harris.

There is very little I can add to our written statement, which I understand will be received into the record, and to what has been stated very eloquently by witnesses that have preceded me. I do think there is one aspect of all this which has not been adequately covered to this point in the hearings, and that is the very special problems that are faced by small business persons who want to have a meaningful retirement system.

I suppose the easiest way to start is with an extreme case. Under section 6 of H.R. 6410, personal service corporations are defined as including corporations whose principal functions are a list of things, including athletes. An extreme case to make a point for what is facing small business is the case of a professional golfer.

I mention that because I also assume they make a lot of money and I am jealous of them. They play golf better than I do. However, every day that man goes out to work he does not know whether that is going to be his last day of working. That is true of many, many people in the small business community, and that is why small business has a particular need for favorable treatment under the pension laws.

We have a greater need than do those who work for institutions. The need to be able to fund quickly for our retirement because we never know whether we are going to make it to 65 and still be working. The horror stories that appear in the newspapers talk about a man who is starting at age 30 to put away $45,000 a year and has compound tax-free interest until he is 65. That man is a rarity, and if he makes it to 65, he is an even greater rarity.

I believe that small businesses could with justification claim that we are entitled to more favorable treatment under the pension laws than any other segment of the community. We are not asking for that. We are merely asking that we be treated the same as every other segment of society.

I will go away from Washington a happy man if I can have the assurance that a small business person, particularly someone in a service industry, will be treated no better and no worse than any other employee in this country, including government employees. That is all we ask, equality of treatment.

However, H.R. 6410 picks out small business and particularly the service element of it, for particularly harsh treatment. We think that is not justified.

I would like to also mention before I close this matter of participant loans. Other panelists have been asked about that. I have feelings about participant loans which I would like to express here. I was born into the debtor class, and I expect to die in the debtor class, so I have a particular interest in this matter of loans. I fail to see how there is any abuse or loophole by letting an employee who has a vested right in a pension plan borrow against that vested right with adequate security and adequate interest.

Under section 6 of the bill, not only would service corporations be put under the Keogh limits on contributions and benefits, they would be put under all other provisions of the Keogh-provisions of the code. That would include the requirement that we would have to have our plans trusteed with a bank.

What that means, coupled with a prohibition against loans, is that if I need to borrow money, I have to go to a bank and borrow at 18, 19, 20 percent, who knows what it will be next year. I have to pay that interest to a bank, if they will make me the loan. At the same time money sits in that trust fund administered by the same bank and which probably has sold me a bill of goods on the proposition they are going to put it in growth stocks which yield 4 percent a year, and go down in value 10 percent per year.

I fail to see any justification for that.

Mr. Nolan identified himself as speaking for 275,000 lawyers in the United States when he said he was against loans from plans. He should have said 275,000 less 2. I speak for myself and Mr. Walsh on this.

Mr. CHRISTL. Let's make it 3.

Mr. RANGEL. Thank you.

[The prepared statement and subsequent letter follow:]

STATEMENT OF MORTON A. HARRIS, ESQ., PRESIDENT, SMALL BUSINESS COUNCIL OF AMERICA, INC. (SBCA)

INTRODUCTION

I am Morton A. Harris of the law firm of Page, Scrantom, Harris, McGlamry & Chapman, P.C. of Columbus, Georgia. I am officially here today in my capacity as President of the Small Business Council of America, Inc. (SBCA). However, I am also appearing as an individual who as an attorney for over 20 years has been involved in the private employee benefits industry as a plan sponsor, a plan administrator, a plan participant and as attorney for numerous qualified retirement plans. Both personally and professionally, I am vitally concerned with the continued vitality and growth of a sound private employee benefit system. H.R. 6410 will severely damage that vitality and growth.

SBCA is a national organization of over fifteen hundred small business and professional men and women located in forty-seven states and American-Samoa whose aim is to represent small business in the area of federal tax and employee benefit legislation, its primary goal being to make these laws more conducive to the good health of small business. A major thrust of SBCA's efforts, since its founding in 1979, has been to identify problems in the small employer plan area and to seek solutions to those problems through Federal regulatory agencies or the Congress. SBCA's constant theme has been to urge the creation of incentives—and the elimination of disincentives—for the establishment and maintenance of private employee benefit plans by small business employers.

BACKGROUND

Last year, in connection with enactment of The Economic Recovery Tax Act of 1981, SBCA devoted substantial time and effort to the enactment of the expanded individual retirement account (deductible voluntary employee contribution) concept. With enactment of that concept, we believe a milestone was reached in the economic and political thinking of our Country and in this Congress. That milestone was the recognition that our economy simply cannot operate with a bias against savings and in favor of current consumption.

Of all the tax incentives provided in the Internal Revenue Code, those provisions which encourage savings for retirement are some of the most sensible. Monies contributed to a retirement plan are not available for current consumption, thus tending to reduce inflation (to the extent inflation is induced by consumer demand). The monies are available for capital investment, be it residential housing or plant and equipment. The monies accumulate in a fund for the contingencies of individual death, termination of employment, disability, or retirement, thus easing future demands on Social Security and other transfer programs. These incentives encourage the private sector to provide for itself, encourage individual initiative, and encourage a productive relationship between employers and employees.[1]

The President's Commission on Pension Policy, in referring to the importance of savings and the status of private pension plans, in its final report stated:

"IMPORTANCE OF SAVINGS

"Individual savings is an important component of retirement income * * *.

"Aside from the importance of savings to the income of the retired, savings also play an important role in the economy because it is a source of capital."

"STATUS OF PRIVATE PENSION PLANS

"* * * the rate of pension growth has slowed significantly * * *.

"The most serious problem facing our retirement system today is the lack of pension coverage among private sector workers * * *."[2]

In acknowledging the "near stagnation of pension plan growth," the President's Commission predicted that the condition would get worse as traditionally low-pension coverage industries (trade and service) grow in relation to the rest of the economy. On this point, the commission further stated:

"The lack of pension plan offerings in small business is a major reason why pension plan growth is expected to continue to stagnate." [2]

Given that background, it seems incredible that legislation such as H.R. 6410 has been introduced and is being seriously considered. This bill is not just a step backward for the private pension system and for the economic and social welfare of our Country, it is a giant leap backward! [1]

STATED OBJECTIVES NOT ACHIEVABLE THROUGH H.R. 6410; AND BASIC ASSUMPTIONS UNDERLYING H.R. 6410 ARE ERRONEOUS

The bill has certain stated objectives and appears to be based on several assumptions. The stated objectives will not be achieved by passage of this bill (it is much more likely that the opposite of these objectives will be the result) and the assumptions are fundamentally erroneous.

(1) H.R. 6410 Would Cause Many Plans to Terminate or Curtail Benefits.—One announced objective of the bill is "to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in pension and fringe benefit plans." The bill can in no way accomplish this objective. In fact, if the bill is enacted, the Internal Revenue Code would then provide incentives which would tend to minimize plan coverage and benefits in favor of putting dollars that would otherwise go into employee benefit plans into other vehicles which provide relief from taxation. It most be remembered that employee benefit plans are voluntary, not mandatory. If a plan becomes uneconomical to maintain, it will be terminated. it can be stated with certainty that many employers, especially small employers, will find it uneconomical to maintain plans under the provisions of H.R 6410. As a result, many plans sponsored by small business corporations (approximately 90 percent of all qualified plans cover less than 25 participants), which provide benefits to a broad base of employees (over 6,750,000), will be terminated or have benefits drastically curtailed. Although this is not the stated intent of H.R. 6410, it will most certainly be the result!

(2) Prior Limits on Pensions Are Not High and Benefits All participants.—A second stated objective of the bill is to reduce what are called "excessively high tax limits on tax-free accumulations under corporate pension plans." The bill certainly will reduce the limits. However, the limits are not "excessively high." Furthermore, it is erroneous to characterize contributions to pension plans as "tax-free accumulations." The contributions are not tax free. Tax on the contributions, and on the earnings thereon, are merely deferred, not avoided. Benefits are taxed on distribution, which typically occurs on death, disability, termination of employment or retirement.

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[1] For information regarding the involvement of small business organizations in the private pension system and the importance of that system to the economic and social welfare of the Country, see SBCA's Statement in Support of Legislation to Provide for Tax Deductible Employee Contributions, attached as Exhibit "A."

[2] Report of President's Commission on Pension Policy, "Toward A National Retirement Income Policy" (Feb. 26, 1981), at pp. 12, 13, 26, 28, 33.

The erroneous assumption that contributions being made to private plans are "excessively high" is based on a naive view of the real costs of providing retirement benefits. Benefits are easy to promise but very expensive to fund. One need only consider the benefits promised by most public retirement systems, the Federal pension System and Social Security. The benefits under both of these programs are seriously underfunded. The unfunded actuarial liability of the Federal Pension Systems has been estimated at approximately one trillion dollars. Taxpayers are presently paying an estimated $5 for every $1 a civil service employee contributes to his or her own pension. It has also been estimated that to properly fund the promised benefits would require 56.4 percent of payroll to be contributed in addition to the present employee and government contributions of some 37.7 percent.[3] The Social Security system is so seriously underfunded that it is difficult to understand how the current level of benefits can ever be realized within the framework of the present system. The unfunded actuarial liability of the Social Security system has been estimated at some six trillion dollars. Yet in all of these programs, benefits continue to be promised with cost-of-living escalators continued unabated. By comparison contributions to private pension plans are not "enormous" or "abusive" or "excessive." They simply reflect what it really costs to properly fund a decent benefit in inflationary times. If the ability to fund private retirement plans is reduced, benefits will be reduced, and that benefit reduction will be across-the-board for all participants, especially for those covered by small plans.

(3) Expected Additional Pensions Will Not Be Realized.—There appears to be an expectation that H.R. 6410 will have a significant and positive impact on revenues received by the federal government. There may be some revenue impact, but it will not be nearly as significant nor as positive as anticipated. In the first place, taxes are not avoided on contributions to plans or on earnings; taxes are merely deferred. Secondly, many provisions of H.R. 6410—such as the loan provisions and vesting provisions—have no revenue impact at all, although they would impose significant costs and burdens on plan sponsors. Thirdly, the assumption that the bill will result in increased revenues does not take account the influence that our progressive income tax rates have on social and economic behavior. The anticipated increase in revenues is undoubtedly based on the premise that if a deduction is eliminate or reduced, the resulting income will be fully taxed. That assumption is wrong!

Our progressive tax rate structure creates an increasing incentive to avoid taxes, the higher the rate, the stronger the incentive to avoid paying the tax. If deductions for contributions to pension plans are reduced or eliminated, the non-deducted dollars will not all become subject to tax since a substantial portion will flow to other tax preferred investments or arrangements, most of which would not have the strong economic and social benefits of employee benefit plans. A real fact of our economic life (on which our private enterprise system is based) is that economic incentives do work! If the Congress provides legitimate tax incentives—such as qualified retirement plans with realistic conditions—Americans will take advantage of them. If, on the other hand, legitimate and economically attractive incentives are not provided, many dollars will flow elsewhere, which will not provide the economic and social benefits as does our private pension system.

(4) Reduction in Federal Benefit Programs for the Needy is No Reason for Destroying the Country's Private Retirement System.—This bill attempts to equate the need for increases in taxes with reductions in spending programs for the needy, and characterizes tax deductions or tax reductions as government subsidies or expenditures. First, such characterization is appropriate only if it is assumed that the government owns all production and income, and that any production or income that citizens are allowed to keep is somehow a gift from the government. The assumption is wrong. Income belongs to those who earn it. Only by their consent, expressed through democratic representation, is the government entitled to any portion of it. Therefore, for proponents of the bill to argue, from a moral standpoint, that a reduction in benefits from a transfer program must be offset by an increase in taxes can be no more than demagoguery which conceals the fact that millions of people, who are relying heavily on their retirement plans, will be negatively affected, thereby putting more (not less) pressure on Government assistance programs.

(5) The Bill Discriminates Against Certain Classes of Workers.—The bill would impose special discriminatory restrictions on the owners of certain small business and professional corporations. These restrictions would limit plan contributions to a maximum of 15 percent of earned income, prohibit plan loans, prohibit voluntary non-deductible contributions, substantially accelerate vesting, delay distributions, and require institutional trustees. Each one of these restrictions carries with it a

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[3] See Statement by Congressman John N. Erlenborn, January 19, 1982.

"cost," and it is difficult to determine how either the public or plan participants can benefit by increasing the cost of sponsoring a plan. In addition, these restrictions should not be applied to small corporations any more than they should be applied to large corporations. These restrictions are "penalties" being applied without reason or justification.

SBCA is particularly concerned with the discriminatory application of the restrictive H.R. 10 rules and other self-employment rules being applied to a specified group of professionals and other providers of personal services. The bill singles out nine providers of services—doctors, lawyers, engineers, architects, accountants, actuaries, actors, athletes and consultants—for this additionally restrictive treatment. With respect to these special restrictions, I will elaborate on only two:

By imposing the full and immediate vesting restrictions of H.R. 10 on these plans, the bill, in effect, causes accelerated funding of pension benefits for short-term employees of these small service corporations. This is contrary to one of the well-recognized business purposes of retirement benefit plans, i.e., to encourage employee longevity and reduce turnover. A graduated vesting schedule helps to accomplish this. A better way to deal with the short-term employee who changes jobs regularly throughout his job career is the expanded Individual Retirement Account created by Congress last year. A good way to continue helping these short-term employees is to increase the annual deductible amount allowable for contributions to IRA's. The proposed legislation, H.R. 6410, would only reduce benefits that would otherwise be paid to long-term employees.

The effective prohibition on loans to participants is another restriction which is without justification. Under current law, participant loans are permissible, essentially, if they are made at arm's length, with adequate security and interest rates, and are available on a non-discriminatory basis. Such loans typically are used in connection with financing a home, providing education for children, or meeting a medical emergency or financial hardship. What possible social purpose is met by prohibiting such loans to certain classes of participants?

This legislation seemingly reflects an attitude that there is something basically wrong with the owners and operators of small businesses and with the men and women who provide personal services. This attitude ignores the fact that the person who is engaged in a small business or in rendering professional services is "at risk." The small businessman or the professional stands and falls on production and productivity. The first paycheck that is eliminated in bad times is that of the owner or the professional. There is no guarantee of the future. There is no instance where the Congress has stepped in to bail out any small business, much less a professional. Yet these are the very people on whom the H.R 6410 imposes additional burdens and costs.

CONCLUSION

Proposals similar to those contained in H.R 6410 were raised in 1969. They were defeated on the Senate floor by a vote of 65 to 25. They again were raised in 1973 in connection with consideration of the Employee Retirement Income Security Act of 1974 (ERISA). They again were defeated on the Senate floor—by a roll call vote of 89 to 2. In 1978, the Carter Administration suggested the same proposals, and they were not even considered by the Ways and Means Committee. The President's Commission on Pension Policy conducted a comprehensive study of national retirement policy and issued a report last year. Nothing in the Commission's report even remotely suggests legislation such as H.R 6410. Other Committees of the Congress have studied retirement policy and laws for a number of years and needed reforms have been proposed (S. 1541 and H.R. 4330) which would substantially increase the incentives for new plans to be installed and for existing plans to be maintained. The thrust of these pending bills is to strengthen (not weaken) the private pension system.

Rather than promoting H.R 6410, which would significantly weaken the private pension system, it is suggested that Congress begin to undo the terrible wrong that has been committed against present and future generations of Americans with respect to the grossly underfunded public pensions by acting decisively and quickly with legislation to foster the growth of the private pension system. It is specifically suggested that Congress encourage the owners of small businesses with stronger incentives to establish employee benefit programs for their employees. In doing this, Congress will properly recognize incentives (in the form of reasonable and adequate retirement benefits) for those whose capital and efforts are at risk. Congress simply should not enact any legislation that imposes special limits or restrictions based solely on the type of business, equity ownership of participants, or form of organization. If H.R. 6410 were enacted, the small business sector—which has created the vast majority of new jobs in our economy during the past decade, and which, if given a chance, will increase pension coverage for millions of its employees—will literally be forced to reduce its efforts to provide privately funded employee benefits. This bill can do nothing but weaken the private pension system, especially plans sponsored by small business organizations where the cost per participant is already high. The obvious result would be that many owners of organizations which sponsor plans would begin funding their retirements as did their forefathers, by private savings, which can be done without providing comparable benefits to their employees.

In summary, there appears to be little or no social or economic benefit to be obtained by H.R. 6410—it can only weaken the only solvent retirement program we have in this Country, i.e., the private pension system, and reduce one of the strongest sources for savings and capital formation. This bill will jeopardize the retirement plans of over six and one-half million participants covered by over 450,000 retirement plans of small business organizations and will severely weaken what may be the last and best hope we have for keeping our free enterprise society—the small business community of America.

Exhibit "A"

Statement of Small Business Council of America, Inc.

TAX DEDUCTIBLE EMPLOYEE CONTRIBUTIONS—BOTH A "SAVINGS MACHINE" AND A PRIVATE PENSION "RESTARTER ENGINE"

Summary

Legislation providing a tax deduction for employee contributions to private pension and other qualified plans would help achieve many of the Administration's stated goals: tax reduction—deregulation—increased savings—capital formation—and relief for the Social Security system. In the process, such legislation would contribute significantly to the growth of the private pension system and the expansion of employee coverage.

All working Americans would be beneficiaries of such legislation; and in addition, the small business community will doubly benefit because a tax deduction for employee contributions would facilitate the adoption and expansion of private pension programs by many small business concerns. This, in turn, would greatly affect the expansion of pension coverage because the major area of noncoverage is in the small business community. A tax deduction for employee contributions would also reverse the growing trend of abandonment of private pension plans for the purpose of satisfying employees' desires to participate in qualified plan investment opportunities through the establishment of IRAs.

The direct consequence of this incentive legislation will be to expand savings, which will contribute to the creation of a capital pool for investment and to the retirement security of working people and their families. In turn, this would reduce the need for expanded social security benefits as a means of assuring retirement security. Finally, the channeling of earnings into long-term savings funds (rather than consumption expenditure) will be noninflationary.

To achieve these benefits, it is necessary that the legislation be appropriately designed to encourage contributions of sufficient magnitude that a recognizably adequate retirement fund can be accumulated. We, therefore, urge that the legislation be simple and easy to understand, that it be uniform in its applicability, and that the allowable deduction be enough to create an effective incentive for both low and middle income earning Americans. Specifically, we urge: (1) that the allowance for a deductible contribution be at least $5,000.00 per year, (2) that the deduction be allowed for all employee contributions, both voluntary and involuntary, and (3) that the deduction be equally available irrespective of whether or not the employee is also covered by a company-sponsored retirement plan. It is essential to the realization of the desired goals that the deduction be fully available to proprietary employees so that the owners of small businesses will have the incentive both to save individually and to institute the company retirement plans.

Introduction

What happens to "small business" is the business of the Small Business Council of America (SBCA). The SBCA is a nationwide group of small business and professional men and women, including attorneys, accountants and other tax and employee benefit consultants, whose aim is to represent small business in the areas of federal tax and employee benefit legislation. Its primary goal is to make these laws more conducive to the good health of small business.

Background

The President's Commission on Pension Policy, in referring to the importance of savings and the status of private pension plans, in its final report stated:

IMPORTANCE OF SAVINGS

> "Individual savings is an important component of retirement income * * *.
> "Aside from the importance of savings to the income of the retired, savings also play an important role in the economy because it is a source of capital."

STATUS OF PRIVATE PENSION PLANS

> "* * * the rate of pension growth has slowed significantly * * *.
> "The most serious problem facing our retirement system today is the lack of pension coverage among private sector workers * * *" [1]

In acknowledging the "near stagnation of pension plan growth," the President's Commission propheisied that the condition would likely get worse as the traditionally low-pension coverage industries (trade and service) grow in relation to the rest of the economy. On this point, the Commission further stated:

> "The lack of pension plan offerings in small business is a major reason why pension plan growth is expected to continue to stagnate." [1]

The SBCA agrees with the Commission's assessment of the problems, but we do not agree with its proposed solution to impose a Minimum Universal Pension System. There is no need for more oppressive pension rules. Instead, there is a strong need for incentives to encourage the adoption and expansion of pension plans by small business owners. One way of doing this is to provide an incentive which will encourage employees to join with their employers in funding for their own retirement. A tax deduction for employee contributions—the same kind of stimulus that has proved to be a powerful incentive for employers—is the simplest and most direct way to create an offer which employees cannot refuse.

No other reasonable approach will be as effective as will a tax deduction for employee pension contributions in enhancing the individual savings "leg" of the "retirement stool," and, at the same time, helping to expand coverage under the private pension system. Additionally, this legislation will help to relieve pressure on the Social Security system a recognized goal of the highest priority. This law would also help to cure the Nation's acute shortage of capital investment funds which should help in solving the need of banks and other savings institutions for greater savings.

A law providing for a tax deduction for employee contributions holds the greatest promise of any plan that has been suggested for encouraging employee savings and expanding employee retirement benefits. It is more efficient and far less complicated than the indirect stimulus provided under the present pension laws and is certainly more appealing than the Minimum Universal Pension Scheme proposed by the President's Commission on Pension Policy. In this connection, please refer to our Statement in Opposition to a Mandatory Private Pension Scheme, submitted to the President's Commission in December of 1981, an extract of which is annexed as Appendix A.

Legilation must be appropriately designed to be effective

There is growing awareness of the desirability of providing a tax deduction for employee contributions to a qualified retirement savings plans, and various bills have been introduced to accomplish this, e.g., S. 12, S. 243, S. 486, S. 1049, S. 1139, H.R. 191, H.R. 2207, H.R. 2346, H.R. 3082, and several others. Therefore, SBCA has less concern that such legislation will not pass than its concern that what actually passes will not be adequately designed to create an effective savings incentive. For example, pending bills generally limit the annual deduction to from $1,000 to $2,500; and although a limit in that range will provide a modest tax deduction and some incentive, it will not allow the accumulation of an adequate retirement fund for most Americans, and thus cannot be expected to significantly inspire the average middle income earning American worker to try and become self-reliant in saving for retirement. The SBCA urges that the limits for deductible contributions be not less than $5,000 per year, which is not an excessive limit when comparing it with the current maximum contributions under Social Security (a combined employee and employer contribution of 13.3 percent on compensation up to $29,700.00) of $3,950.00 for 1981, an amount which is scheduled to rise considerably higher within the decade.

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[1] Report of President's Commission on Pension Policy, "Toward A National Retirement Income Policy" (Feb. 26, 1981), at pp. 12, 13, 26, 28, 33

To provide consistency and some measure of simplicity in the pattern of tax incentive for pension, profit sharing and IRA contributions, it is urged that the deduction for employee contributions be equally available for employee contributions to either an employer-sponsored plan or to an IRA or to both, and that the deduction be available for both mandatory and voluntary contributions.

Must encourage employees to become responsible for their own retirement

Probably the most basic reason for providing a tax deduction for employee savings contributions is inherent in our right to the "pursuit of happiness" which must include a secure retirement and the corresponding responsibility to contribute toward that retirement. With the present tax structure against the backdrop of inflation, there is simply no way for the average American worker to adequately save for his own retirement.

Present tax laws—both ineffective and counterproductive

There is no longer a serious question that retirement planning must be a three-way partnership among Government, employers and employees, often referred to as the "3-legged stool" of retirement planning. The funding for two of the "legs," Social Security and employer pensions, is largely subsidized by the tax system. Why should it not be equally appropriate that the third leg, private savings, receive a similar tax stimulus.

Although a deduction is presently allowed for personal savings when funneled into an IRA, the combination of the low contribution limits ($1,500 per year) and the inability of those covered by qualified plans to participate has caused the IRA to be largely ineffective in encouraging employee savings. In some cases, the IRA rules have actually caused the termination of qualified pension plans at the insistence of employees who prefer the control and flexibility of an IRA account. In other cases, employees have individually chosen to withdraw from participation in their employer's qualified plans in order to make themselves eligible to establish their own IRAs. Sometimes this has adversely affected the qualification of the employer's plan because of the withdrawals reducing the ratio of the "non-prohibited" participants. In some cases, it has simply induced the employers to abandon the "unwanted" pension plan altogether.

Incentive for expanding pension coverage

The President's Commission on Pension Policy observed that the principal deficiency of our private pension system is the large number of people not covered by it at all. Tax incentives to promote a substantial deduction for employee contributions to qualified plans would significantly encourage the retention of existing plans and the formation of new ones.

First, if employees could obtain the same tax advantage by contributing to their employer's plans as they could under their own IRAs, they would likely remain in their employer's plan, thereby benefiting both from their own contributions and from their employer's.

Second, a deduction for employee contributions to either pension, profit sharing or thrift plans will encourage employers who are incapable of fully funding a meaningful retirement program to combine their contributions with those of their employees to install such programs. This would be particularly attractive to small businesses where marginal payroll costs are often the difference between staying in business or failing. If a portion of the costs of the plan can be borne by the employee, the employer will be more capable and more receptive to adopting such a plan.

Third, the availability of an employee deduction will encourage the further development of thrift plans (providing for matching contributions by employer and employee), which are increasingly popular with employees. Thus, retirement plans that would never otherwise have been considered would come into existence. This, in turn, should lead to other plans being adopted and to expansion of initially modest plans as the competitive forces of the job marketplace come into play. It is likely that a significant business community where most of the non-coverage exists.

Relief for social security

A deduction for employee contributions will serve to stimulate both private savings and the private pension system, which will provide needed relief for the third "leg" of the retirement stool, Social Security. The malaise in the Social Security system, which for years has been hinted at by professionals, is now front-page news. Concerns for the solvency of the Social Security system have never been greater, particularly among young and middle aged people, many of whom seriously doubt whether the system will be able to deliver when they are ready to draw from it.

Due to the urgency of the problem, there is growing support for legislation to solve the current Social Security crisis and head off threats of its bankruptcy. At the same time, our country's savings rate is currently at its lowest ebb and the growth of private pension coverage has stagnated, thus creating growing dependency on the already overburdened Social Security leg. It is, therefore, timely and indeed urgent that we strengthen the other two 'legs" which will immediately and significantly relieve the strain on Social Security. Viewed in this light, the deduction for employee contributions must become an integral component of the current proposals to protect the financial integrity of the Social Security system.

Advancing national goals: Capital formation. reduction of taxes, inflation and regulations

It is hard to conceive of a program more consonant with this Nation's current priorities than a tax deduction for employee contributions to qualified retirement plans. The capital formation potential is self-evident and with the employee savings being channeled into qualified trust vehicles, a most efficient way to deliver funds to capital markets. Legislation of this kind will impact directly upon the economy by making funds available for business and the enhancement of productive capacity. At the same time, money will be diverted from consumption to savings, thus reducing inflationary forces on the economy, which, in turn, will help preserve the value of funds accumulated for retirement.

Personal taxes will, of course, be reduced by the proposed new deduction, thus raising the fear that an increased deficit will only heat up an already overinflationed economy. It should, however, be noted that the amounts of savings will be considerably larger than the reduction in taxes, thus making it clear that the deduction cannot aggravate, but will, indeed, help reduce the level of inflation. Moreover, the savings will guard the individual against the catastrophe of having to live his or her retirement years under multi-digit inflationary conditions without reserve funds. The tax deduction will both enable and encourage workers to establilsh their own retirement pools, free of taxes, in a form that itself is responsive to inflation.

All of this can come about with essentially no additional government regulations, provided the new legislation is not cluttered with self-defeating "anti-discrimination" rules, and not saddled with complicated reporting and other requirements.

Need for significantly higher level of deductible amount

It is essential that the Congress not water down the tremendous savings incentive which can result from a tax deduction for employee contributions to retirement savings. To be effective, there must not be overly restrictive limits on the amount of the deduction, or restrictions which permit the deduction only for voluntary contributions, or restrictive limitations on eligibility of who can participate.

While it is appropriate that some limit be imposed on the amount of the savings deduction, it should be recognized that it is not possible for a meaningful retirement fund to be accumulated at the current $1,500 IRA limit, the average limit of pending bills. First, the $1,500 annual limit does not reflect the severe inflation experienced since that limit was initially imposed in 1974. Second, the accumulation possibilities at the rate of $1,500 a year are very limited, i.e., only $30,000, plus earnings, after a 20-year period. It is not necessary to determine at what level the fund will earn since past experience indicates that we cannot anticipate that earnings on the savings fund will do much more than keep the real value of the fund from depreciating with inflation.

The early experience under H.R. 10, when a $2,500 limitation was in force, makes it clear that people will not rush in great numbers to establish new plans for minimal immediate benefits. The administrative costs involved in establishing the plan and managing the fund will often outweigh the benefits of the plan when the maximum benefit levels are too low. It can be argued that the present H.R. 10 limits of $7,500 or 15 percent of compensation provide a reasonable precedent for setting the limit for employee deductions, since the H.R. 10 contribution is itself in the nature of a voluntary employee contribution. However, in recognition of the short-run revenue impact of a large new tax deduction, the SBCA suggests that a more modest limit be set at this time. A logical maximum contribution limit might be tied to the prevailing Social Security contribution rate (presently a total of $3,950), as previously stated. Although this would bring the private incentive limit to the same level as required under Social Security, with each "leg" of the "retirement stool" having the same strength in serving the retirement needs of our Nation's employees, it is recommended that a better alternative to such a constantly moving figure would be the establishment of a reasonably related fixed figure such as $5,000, which would remain constant until moved by Congress. The main virtue of doing this is that the $5,000 limit would, in time, become generally known, and the occasions for erroneous calculations and over contributions would thus be reduced.

Voluntary vs. involuntary contributions

A tax incentive for employee savings should be provided for both voluntary and involuntary employee contributions. Some of the legislative proposals would permit the deduction only for contributions that are not mandatory. Such a distinction cannot be easily justified since pension plans come in many designs and in some cases, a mandated employee contribution provides the trigger for a contribution by the employer. In other cases, employees are nominally free to contribute or not, but the economic compulsion is applied in the form of a matching contribution from the employer. Presumably the rationale behind proposals to limit the deduction to voluntary contributions is that no tax incentive is needed to encourage one to make a mandated contribution. However, this rationale does not take into account the varied types of qualified plans and circumstances involved, nor does it recognize that employees will often voluntarily contribute more if given the tax encouragement to do so.

To make such a distinction is not only unfair but would create additional complexity in the administration of the law due to the many varieties of plans and the difficulty of determining whether or not employee contributions are "voluntary" or "mandatory." Further, it would inspire all sorts of drafting flourishes to design plans around this constraint. Moreover, the "voluntary"—"mandatory" dichotomy rests on a fallacious view of what is "mandatory" in this context. See, for example, S. 243, which defines a "mandatory contribution" as one "required as a condition of participation in a plan" or of "obtaining benefits under the plan attributable to employer contributions." The "mandating" is obviously simply a matter of plan design; but the probable interpretation of such language would be to prompt the redesign of every so-called thrift plan in the country. From the standpoint of an employee's security, and from the standpoint of the health of the economy, and, further, from the standpoint of encouraging simplicity and fairness, there should be no significance to whether the employee's contribution is voluntary or mandatory.

Small businessmen need an irresistible incentive

Too often Congress has succeeded in incensing small businessmen. ERISA is a classic example. Congress, by providing a tax deduction for employee contributions to qualified plans, now has an opportunity to create an irresistible incentive for small businessmen to do something for their employees by doing something for themselves. To accomplish this, it is necessary that proprietary and executive employees be given the same savings opportunities, proportionate to their salaries (and subject to appropriate limits), that are given to all other employees.

To unduly limit the deduction by proprietor-employees, would have the effect of nullifying the opportunity to achieve the various benefits that can be achieved from our tax deduction proposal; since the surest way to inspire a small company to institute a benefit advantageous to rank-and-file employees is to give the proprietary employees a meaningful incentive to participate in the benefit. It is, of course, entirely appropriate to require that benefits available to owner-employees also be available to the rank-and-file; but to deny to proprietors what would be available to the rank-and-file is, in most cases, to deny the benefit to everyone. Recognizing that even though the most noncoverage under qualified plans is in the small business community, over 90 percent of the over 500,000 total qualified pension plans in the country are in small businesses (those with under 100 employees), it is, therefore, suggested that the number of small plans might be vastly lower if shareholder-employees were restricted in their ability to benefit under the plans.

Conclusion

Congress should take the opportunity to follow a path that other nations have seen the wisdom of pursuing. By providing an adequate tax deduction for employee contributions to qualified retirement plans, employees will be helped to help themselves and to help the Nation. This incentive can be the "engine" which will restart the expansion of pension plans and rebuild the Nation's fund of private savings.

MORTON A. HARRIS, *President.*
ALVIN D. LURIE, *Special Counsel.*

APPENDIX A

Extract from "Statement in Opposition to a Mandatory Private Pension Scheme," submitted to the President's Commission by Small Business Council of America, Inc. on December 12, 1980

"Not only would many workers have to be laid off my small business, but many small businesses would die under the compulsion of added payroll costs. Small businesses, which employ more than half of the American work force, are both far more marginal and far more cyclical than large corporations. They are, therefore, subject to greater economic pressures. An increase in the marginal cost of each employee may not affect an employer of ten thousand workers at all, but will have a very major effect on an employer of ten workers. In response to competitive pressures, and increase in the cost of labor must inevitably decrease its use. Therefore, the requirement that small businesses provide pension benefits to their employees, which increases the cost of employing each worker, must decrease employment opportunities in the economic sector in which most jobs are created. Unemployment will inevitably rise, as marginal workers, the young and minority group members, are laid off more rapidly, and hired more slowly.

"The experience will be much different than that which followed enactment of ERISA. ERISA's passage left small business with several choices, all unpalatable, but choices nonetheless: one, to drop their pension plans altogether; two, to switch into less burdensome types of plans, as the massive post-ERISA switch to profit-sharing plans demonstrates; three, to drop employer-funded pension and profit-sharing plans in favor of employer-sponsored IRA and SEP programs, as growing numbers of companies appear to be doing; or, finally, to bear the pain and save their existing plans. At least under ERISA, there was a choice. A mandatory program leaves small businesses that cannot bear the pain no choice, save to go out of business (or never start the business in the first place).

"Hence, a mandatory scheme which has as its immediate goal the expansion of retirement plan coverage can, in fact, swiftly contribute directly to the contraction of coverage; for with no employer to sponsor the retirement plan, there is no plan, and, indeed, no job."

MURDOCH & WALSH,
Wilmington, Del., June 18, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR CHAIRMAN ROSTENKOWSKI: I attended the June 10 hearings on H.R. 6410 and was present from beginning to end—in fact, I was the end being the last witness before the committee.

I'm not writing to add anything to my written or oral statement. Instead, I'm writing to get myself on record as disassociating myself from certain comments made by John Nolan allegedly on behalf of the American Bar Association.

At page 6 of Mr. Nolan's written statement, he urged that the increase in Keogh plan deduction limits be coupled with an increase to $400,000 in the base with respect to which such contributions can be made. Mr. Nolan pointed out that failure to take that step would mean that in order to reach the $30,000 level, the self-employed person would have to contribute 15 percent of the compensation for common law employees. This Mr. Nolan referred to as a "unreasonable high contribution rate."

As I understand what Mr. Nolan said at the hearing and in his written statement, he's seriously contending that a self-employed person earning $200,000 or more per year would think it unreasonable to contribute to a pension plan 15 percent of the compensation of his employees. Please let the record show that I absolutely repudiate that as representative of my position. I suspect that that does not reflect the feelings of a large number of members of the American Bar Association. I'm sorry to say that I never anticipate earning $400,000 per year, but I can assure the Congress that if I ever did, I would not begrudge my rank and file employees a contribution of 15 percent of their pay.

During his oral presentation, Mr. Nolan went out of his way to state that he was flatly opposed to participants in pension plans being allowed to borrow from the plans but that he might concede on this point to the extent of approving a provision which permitted participant loans in the event of extreme financial hardship. On this same point, see page 5 of Mr. Nolan's written statement.

I state categorically that Mr. Nolan's statement with respect to participant loans does not reflect the views of the American Bar Association or of any subsidiary organization of that body. I challenge Mr. Nolan to produce for the committee any evidence that any duly organized committee or section of the American Bar Association has ever approved his statement with respect to plan loans.

There seems to be an assumption abroad (in part fostered by Mr. Nolan's statement) that permitting a participant in a qualified retirement plan to borrow from the plan is inconsistent with saving for retirement. I deny that assumption.

In these days of sky-high interest rates and extreme difficulties for ordinary citizens when it comes to borrowing, I am at a loss to understand how anyone can seriously say that borrowing from a bank, an insurance company, a finance company or a pawnbroker is consistent with saving for a retirement but borrowing from one's own pension plan is inconsistent. If a forty year old participant in a pension plan is able to borrow $50,000 from his pension plan in order to purchase a home and pays reasonable rates of interest and amortizes the loan in accordance with usual commercial standards—why is he better providing for his retirement by making such a loan from a bank rather than from his own pension plan? I'm ready to be convinced on this point, but so far have not heard any arguments which do that.

Respectfully submitted.

CONVERSE MURDOCH.

Mr. RANGEL. Mr. Conable?

Mr. CONABLE. I thank the panel. I think it is an interesting and diverse panel and I think we have learned something from your testimony.

Mr. RANGEL. No question about that.

I thank you for the full committee and the Chair, and the record will remain open for a short period of time for the purpose of adding additional testimony.

We thank you, the last panel, for your patience in waiting this very, very long day, at least for some of us.

The committee stands adjourned subject to the call of the Chair.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

[The following material was submitted for the record:]

GREG ABRAMS,
Los Angeles, Calif.

Hon. DANIEL ROSTENKOWSKI,
Washington, D.C.

TO THE HON. DANIEL ROSTENKOWSKI: H.R. 6410, or the Pension Equity Tax Act of 1982, has been misnamed. It should have been called "The Private Pension Plan Destruction Act of 1982."

Social Security, which is in serious financial trouble, was designed to provide a floor of income upon which individuals could build so that they could maintain a reasonable standard of living after retirement. However, certain factors such as the high cost of living and taxation make it almost impossible for employees to put after-tax money aside for their retirement years. Without this supplemental savings, and having only Social Security benefits upon which to depend, these employees will not be able to afford to retire.

Private retirement plans are a means of providing that supplemental savings. The tax advantages of these plans have given incentives to the owners of small businesses to develop retirement plans to provide benefits for themselves and their employees.

If this legislation is enacted, there will be a dramatic decrease in the installation of new plans and wholesale termination of existing plans. This will defeat the Congressional intent expressed in ERISA.

There are specific portions of the bill which are particularly unfair and will work a hardship on all those employed in the small business sector. The proposed legislation with respect to the 415 limitations is grossly unfair. Not only will there be a drastic reduction in benefits and contributions, but cost of living adjustments will be eliminated entirely. In view of the fact that governmental plans benefitting our elected officials currently provide for a 100 percent post-retirement cost of living adjustment, I cannot help but wonder if this proposed legislation does not discriminate unfairly against private citizens such as myself.

Plan participants will be retroactively penalized if they make participant loans in the period between the proposal of this legislation and its enactment. This provision will cause extreme hardship on innocent persons.

Clearly, Congress has picked out a target in the professional corporation. Once again, however, Congress has proved shortsighted. Those employees who will be hardest hit by this legislation will not be the owners or the highly compensated. There are other avenues open for those seeking tax shelters, the limitations of which are almost non-existent for those with imagination and the means to afford them. It will be the rank and file employees who will be placed under the greatest hardship by this legislation. For most of these employees, private pension plans have provided a degree of security that they could not afford by themselves.

I urge you to consider the ramification this bill will have on all employees of small businesses. I also urge you to vote against this bill. It is important that small businesses, whether they be composed of professionals or other small business employers, should not be treated differently from large businesses for purposes of qualified retirement plans. ERISA was enacted in order to protect the rights of the rank and file employees who participate in qualified retirement plans. H.R. 6410, it appears, will make much of that protection moot for those employees whose companies cannot afford to make retirement plans available to them.

Pension plans of the private sector, which this bill attacks, provide a large pool of funds for capital investment which Congress can't afford to allow to dry up due to this illconceived legislation.

Sincerely,

GREG ABRAMS
(And others).

STATEMENT OF THE AIR LINE PILOTS ASSOCIATION

The Air Line Pilots Association, representing the interests of approximately 33,000 members who fly for 36 airlines, appreciates the opportunity to express the views of the Association on H.R. 6410, The Pension Equity Tax Act of 1982.

The Association is strongly opposed to this legislation as it is currently drafted. Enactment of this proposal would have a very serious adverse impact on nearly all of our pilot retirement programs, and it would fall far short of its desired goals of increasing Federal revenues and achieving greater equity in the treatment of private pension plans. The following reflects our specific objections to H.R. 6410.

CONTRIBUTION AND BENEFIT LIMITATIONS

Under current law, contributions and benefits provided through corporate pension plans are limited. The limitations were established in 1974, when ERISA was passed, at the lessor of 25 percent of pay or $25,000, as the maximum yearly contribution to defined contribution plans, and the lessor of 100 percent of final 3-year average pay or $75,000, as the maximum expected benefit at normal retirement date from defined benefit plans. The $25,000 and $75,000 amounts were indexed for cost-of-living changes, so that in 1982 they are $45,475 and $136,425 respectively. A further rule of current law is that employees covered by both kinds of plans may not receive the full maximum under both plans. They may receive only 140 percent of the sum of the two maximums. This "1.4 Rule," of "140 percent Rule," is applied for each individual each year by determining two fractions and adding them together, as follows:

Defined contribution plan fraction plus defined benefit plan fraction equals 1.4.

Annual contribution divided by $45,475 plus estimated benefit at normal retirement age divided by $136,425 equals 1.4.

H.R. 6410 would change these rules as follows:

1. The maximum dollar amount would be reduced from $45,475 to $30,000 as an annual contribution, an from $136,425 to $90,000 as an expected benefit.
2. The new dollar amounts would not be indexed for inflation—they would remain at $30,000 and $90,000 respectively.
3. The $90,000 limit would be available for retirement at or after age 65 only. It would be reduced for pilots, who are required to retire at age 60, and for anyone who retires at an age earlier than 65.
4. The "1.4 Rule" would be changed to a "1.0 Rule", so employees covered by both plans could receive only 100 percent of either maximum, or some combination thereof.

The effect of these proposals, if enacted, would be disastrous for our members. The most significant provision of H.R. 6410 for the Association membership is the proposal to reduce the defined benefit plan maximum in the event of retirement prior to age 65. We believe it is unreasonable to change the current law provision applying the full maximum for retirement at or after age 55. It is outrageous, however, to consider making such a change applicable to employees who do not have the opportunity to continue working to age 65 because of federal requirements forcing them to retire earlier. Airline pilots are required by Federal Aviation Regulations (FAR 121.383(c)) to retire at age 60. Existing pension legislation recognizes this fact in the area of comparability of plans and prohibited discrimination, with a specific provision in Internal Revenue Code Section 410(b), added by ERISA. We believe it would be wise to follow this precedent. H.R. 6410 does not indicate which actuarial reduction formula would be used to reduce the maximum. We have estimated that the maximum would be reduced at least 35 percent for retirement at age 60, though other estimates we have seen put the reduction at 48 percent. Nearly all of our plans would be immediately affected if such a reduction were adopted, and certainly all would be affected over the longer term.

The specific reduction in the dollar limits for contributions and benefits appears to be very arbitrary. The initial limits were set by ERISA after careful study, and have been increased only to keep pace with the cost-of-living. We do not believe it is reasonable to arbitrarily reduce limits which have been in effect since 1974 and have worked effectively, without thorough study and thought.

While the reduction in the dollar amounts is of great concern, the elimination of any future indexing of these limits is considerably more alarming. An obvious traditional goal of pension plans has been to provide a standard of living in retirement which relates to the employee's pre-retirement situation. Thus, pension benefits are projected as a percent of salary. If the amount of benefits which can be provided is set at an arbitrary limit and never adjusted, future retirees cannot hope to even begin their retirement with a reasonable replacement ratio (the ratio of pension to salary). Since most private pension plans do not provide cost-of-living increases after retirement, the retiree's standard of living can only decrease. This situation is difficult enough when the initial pension amount is adequate as a percent of salary; it would be extremely harmful if that initial amount were cut back due to dollar limits sent in 1982 and never adjusted. It may be argued that these limits would be raised via new legislation whenever necessary if the automatic adjustment is eliminated. We feel that such a Band-Aid approach is very short-sighted and wasteful and could well cost as many tax dollars as might be saved by adopting the proposal.

The Association is also concerned about the proposal to reduce the combined limits in cases where employees are covered by both a defined contribution plan and a defined benefit plan. The purpose for the existing 140 percent limit was to allow employers to maintain both types of plans, since each type serves a different purpose. Over two-thirds of the plans covering ALPA pilots, representing 87 percent of our membership, involve a combination of the two types of plans. The philosophy behind the negotiation of two plans has been to provide a basic benefit with a defined benefit plan and an inflation-buffer with a defined contribution plan. This philosophy has become even more valid in today's economic climate. We believe these carefully structured retirement systems would be irreparably harmed by this proposal, to the detriment of employees at all points on the wage scale.

DISCRIMINATION IN FRINGE BENEFITS

H.R. 6410 would add a new section to the Internal Revenue Code to prevent any fringe benefit plan from providing different benefits for the highest paid 15 percent of the employees of a company than for other employees. We believe this provision improperly restricts the rights of employees under a freely functioning collective bargaining environment. It is not unusual for employees in a collective bargaining unit to negotiate benefits different from those of another group. Certain of these benefits will be more beneficial to employees in the group, while other benefits may be less. For example, one bargaining unit may negotiate a lower medical plan deductible amount, but offset the effect of this by requiring the employee to pay a higher rate of co-insurance. If the plan covers only employees in that particular unit, and some of those employees are among the top 15 percent of the company's employees, all of their benefits under the plan would be taxed, simply because the plan has one provision which is more beneficial than another plan. This would have the ludicrous effect of eliminating the right of employees in different bargaining groups to bargain separately for their benefits. The history of collective bargaining has been carefully formulated over many years and the collective bargaining process in itself prevents discrimination on behalf of the highly paid. If this proposal is made applicable to all benefit plans whether collectively bargained or not, years of responsible labor relations will be upset, wreaking havoc upon medical and insurance plans long in existence. We do not believe this is the intent of the proposal. We urge you to consider this possibly and, if these provisions of H.R. 6410 are enacted, to apply the test separately for collectively bargained plans, excluding employees not in the bargaining unit.

OTHER PROVISIONS

Certain other provisions of H.R. 6410 are of concern to the Association as well. We feel that proposals regarding Social Security integration are extremely vague as to their application to the various types of defined benefit plans. Also, they would appear to require calculations on behalf of each individual plan participant, which could be extremely complex and costly. We would suggest that more thought be given to those proposals in view of the complexity of the issue.

We feel that the provisions disallowing plan loans to certain employees would again stand in the way of reasonable collective bargaining. Collectively bargained plans should be exempt from this rule.

Finally, we see no reason for imposing a limitation on the estate tax exclusion allowed under current law. Further, the proposed limitation does not seem to take into account the many plus which provide survivor income benefits. It would be an administrative nightmare to determine the lump sum value of such benefits for purposes for estate taxation since each individual situation is completely different. A relatively low-paid person who dies leaving a young wife and small children might have a large amount added to his state by virtue of survivor income payable to his family, while an older, more highly compensated employee without dependents would have none. The administrative costs of figuring this out could far outweigh the taxes gained. This provision should be studied in much greater detail before being considered.

We appreciate the opportunity to share our views with the Committee.

AIR TRANSPORT ASSOCIATION OF AMERICA,
Washington, D.C., June 17, 1982.

Hon. DANIEL ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The Air Transport Association of America, which represents the scheduled airlines of the United States, wishes to take this opportunity to comment upon certain provisions of H.R. 6410, "Pension Equity Tax Act of 1982," particularly those which affect benefits for airline employees. The airlines currently employ approximately 350,000 people and provide a broad variety of benefit plans, including both defined benefit and defined contribution plans. Insertion of these comments in the record for the hearing held on June 10, 1982 will be appreciated.

H.R. 6410 was introduced on May 18, 1982, and was scheduled for hearing before the full Committee on Ways and Means just 21 days later on June 8 (later postponed to June 10). The short time between introduction and hearing of this complex subject has been insufficient to permit the airlines to make a complete analysis of H.R. 6410 and the impact of its provisions on all of their plans. However, a preliminary review has disclosed the following problem areas.

AGE 65 RETIREMENT

Under present law, if the retirement benefit begins before age 55, the annual limitation is actuarially reduced to the equivalent of the benefit limit of age 55. Under the bill, if the retirement benefit begins before age 65, the annual limitation is actuarially reduced from that age.

Because of Federal Aviation Administration safety regulations, airlines retire their career pilots at a maximum age of 60. Existing airline retirement plans provide full benefits for these skilled professionals at age 60. H.R. 6410 would require that retirement benefits be actuarially rolled back approximately one-third for this group of airline employees. Additionally, other groups of airline employees have been provided with similar plans which provide full retirement benefits earlier than age 65. The bill would likewise require that their benefits be actuarially reduced.

REDUCTION IN BENEFIT LEVELS

Provisions of the bill would reduce benefit levels without an annual adjustment for inflation. The new dollar limit for a defined benefit pension plan would be $90,000, down from the present $136,425, and down to $30,000 from $45,475 for a defined contribution plan. The airlines believe that such a reduction would have a limited impact initially. However, without an appropriate cost of living adjustment, the reduced limits will affect most, if not all, employees in time. Wages for individuals entering airline employment today with historic wage progression added to inflation will most certainly exceed the proposed reduced benefit levels by retirement age.

Additionally, preliminary review indicates that the proposed reduction in limits under multiple plans from 1.4 to 1.0 may adversely impact on those airlines which provide both defined contribution and defined benefit plans.

OTHER CHANGES

The airlines reserve comment on other changes proposed by the bill for two reasons. First, the proposed changes in special rules applicable to plans covering self employed individuals and plans of professional service corporations may not affect the airlines, but further analysis is required. Second, analysis has been deferred on the impact of the proposal to restrict loans to plan participants and to change the rules for integration with Social Security because of inadequate time and reluctance to incur the costs associated with such analysis. For example, one major airline with 13 separate benefit plans estimates that it will cost $200,000 to analyze fully the impact of changes proposed by H.R. 6410 on its plans.

The airline industry is struggling to overcome record financial losses and should not be burdened with additional costs which would be required to evaluate potential changes in benefit plans under H.R. 6410. The Air Transport Association urges that changes, if they are needed, be limited at this time to plans covering self employed individuals and plans of professional service corporations. It is further urged that airline plans continue to be administered under current rules and regulations of the Internal Revenue Code.

The airlines appreciate the opportunity to present these views.

Sincerely yours,

William J. Burhop.

Statement of Gregory L. Leatherbury, Jr., Chairman, Tax Section, Alabama Bar Association

1. The effects of H.R. 6410 cannot be properly measured or even understood in the short period of time between the date of introduction of this Bill (May 19, 1982) and the scheduled date for hearings, Tuesday, June 8, 1982.—The issues posed by H.R. 6410 are so large in nature and so important to so many working Americans that they deserve very careful study. They should not be tacked onto the debt ceiling bill but rather deserve serious, lengthy deliberation. If the Bill were to become law, there would be a serious breach of trust with people who have relied on the ERISA pension scheme. The ERISA scheme was subject to intensive debate and carefully thought out, and provides a very reasonable answer to national pension policy. Most people are unaware of the Bill as the proposed law has received little publicity. Therefore, Congress will receive much more criticism about this Bill as its contents become known and understood.

2. Unfair discrimination.—The Bill unfairly discriminates against "personal service corporations", which are composed of lawyers, doctors, engineers, architects, accountants, actuaries, persons engaged in the performing arts, athletes and consultants, and their employees. The Bill proposes lower retirement plan limits for the preceding organizations than for other corporate entities.

3. The Bill will encourage bad tax shelter investments and produce less revenue for the U.S. government than the current pension law.—There are, admittedly, some very wealthy professional people and athletes who have large retirement plans. While there are some high income earners in some professional groups, to change the whole scheme of the pension law because of a few wealthy individuals would be to throw the baby out with the bath. The few wealthy individuals who are contributing large sums to their corporate retirement plans, if this new law is passed, will simply hire sophisticated tax advisers to advise them with respect to tax-sheltered investments. The current pension system encourages significant investments, and it only delays tax since the benefits paid from it are taxable. We submit that the present retirement plan system will provide more revenue than would a diminished retirement plan system, because the latter would foster more tax-sheltered investments. Even if some revenue enhancement would be achieved by H.R. 6410, which is doubtful, H.R. 6410 is poor public policy. The benefits, if any, are not worth the cost.

4. Rank-and-file employees will have their pensions cut at a time when Social Security offers little meaningful retirement assistance for those who are not presently retirement age.—The present Social Security System is on the verge of bankruptcy. See U.S. News & World Report, June 6, 1982, page 35, which reports that every hour the Social Security System "loses one million dollars." Our elderly population is both growing and becoming less and less economically self-sufficient. There is a smaller ratio between those in the active work force, paying for Social Security benefits, and those who have retired and are on Social Security, depending on the current workers. In an era of inflation and rapidly rising health care costs, H.R. 6410 will undermine the private funding of pension plans at a time when they should be encouraged, not discouraged.

5. The pension law has been amended several times in the form of statutory changes and regulation changes since 1974, when the Employees Retirement Income Security Act was passed. Further changes will cause elimination of plans due to operational, legal and accounting expense.—Many changes have been made in the pension law since 1974 when ERISA was implemented. The basic purpose of ERISA was very good. We are not criticizing this. It is inevitable that some regulations must be adopted and changed and that plan amendments must occur. However, ERISA required plans to be amended by 1976, required additional amendments due to 1978 regulations, and IRS Notices 82-7 and 82-8, just issued last month, require all individual plans and prototype, basic, pattern and master plans to be amended in view of the change Congress made in 1980 to Internal Revenue Code Section 414 by adding Subsection 414(m). Additional changes are an unbearable expense at this time to many small employers. They will cause the elimination of plans, which is to the detriment of rank-and-file employees.

The Bill would also require 100 percent vesting for professional service organizations. This will also vastly increase the overhead of these plans, requiring short-term employees to be covered in the same way as loyal, long-term employees. This will unfairly increase the overhead costs for the employers and cause the elimination of many plans, which will deprive many people of retirement benefits they had counted on.

6. H.R. 6410 is inappropriate at a time when government pensions have become fat and other government fringe benefits have become fatter.—Congress exempts itself and other governmental employees from Social Security. Small businessmen must pay Social Security taxes for their employees without having any realistic expectation of benefits from this system as it is presently structured. Consequently, government employees are unfairly exempting themselves from the burden of providing for our aging population.

In addition, Congressmen and Senators last year voted themselves a $19,000 audit-proof income tax break at a time when, through H.R. 6410, they want to increase income taxes on other working Americans. There is also double-dipping and triple-dipping in the federal pension system. Many federal employees will retire with tremendous federal pension benefits (perhaps 2 or 3 such benefits) and then join the Social Security System for a short period of time and then get an additional Social Security benefit from private sector employment. The increasing disparity between the retirement security of government employees and the insecurity of middle class and small businessmen is another reason to reject H.R. 6410. If revenue enhancement is desired from pension reform, please also review governmental and big business pension rules before changing the rules on those in America's service professions.

7. H.R. 6410 will exacerbate the current shortage of investment capital.—Pension funds are a major source of investment capital and recent articles indicate that they will be a major source of funding for home mortgages. A reduction in the private pension system will reduce the capital needed in the American economy.

8. A high level of benefits for executive employees and professional and small business is necessary for high benefits for rank-and-file employees.—Pension benefits for most organizations are structured for the executives. If they have large benefits, ERISA requires that the other employees be given proportionately comparable benefits. If the executives' benefits are diminished, the organizations will not generally maintain benefits for the rank-and-file employees at the same level. They will be reduced. H.R. 6410, if passed, would then put increasing pressure on the already collapsing Social Security System and public support network.

9. Participant loans should not be eliminated for executives and shareholders as they provide good investments and a necessary safety valve for needed liquidity.—Participant loans to all employees, including key employees, have frequently been one of the best investments pension and profit-sharing plans can make. They are almost always repaid and generate a high rate of interest, which is required by law. Internal Revenue Code Section 4975 and ERISA Section 408 require such loans to be repaid in full at a "reasonable rate of interest." This is generally interpreted to be a rate of interest at or near the prime rate of interest. If loans are eliminated, small businessmen will be less likely to adopt retirement plans at all because they will have no access to the funds in the event of a financial emergency. The assumption of H.R. 6410 is that these loans are somehow "bad." On the contrary, they are good because they encourage the establishment of ERISA plans and they provide excellent investments for the plans themselves.

10. H.R. 6410, by eliminating inflationary increases in pension benefits, will result in inadequate pensions for persons presently entering the work force.—An employee earning $30,000 per year at age 25, whose salary compounds at a 5 percent annual rate, will receive a pension benefit under H.R. 6410 of only 40 percent of his final pay. This would mean that a person making $30,000 in current dollars would receive a final pension of only $12,000 per year. For a more highly compensated employee, the pension would be even less as a percentage of his or her income.

If it is believed by Congress that corporate plans are better because they realistically keep up with inflation, then the remedy is not to eliminate indexing for inflation from corporate plans, but to add indexing for inflation to Keogh plans and individual retirement accounts.

11. H.R. 6410 is a drastic change in public policy which itself will undermine faith in the tax law and the pension system in particular.—Congress has been making rapid changes in the tax law during recent years. This "zig-zag" approach to public policy and tax planning erodes national confidence and makes our tax laws look like a game to the citizenry rather than a well thought out mechanism for raising needed revenue in a fair way. The adoption of H.R. 6410 will cause a massive tax revolt in the middle class, taking away the only valuable investment that many have had. Homes, which have been a nestegg of value for many people, cannot now necessarily be relied upon. The retirement plan is the one remaining economic security that should not be so drastically curtailed.

Thank you for considering our views.

Respectfully submitted,

GREGORY L. LEATHERBURY, Jr., *Chairman.*

ALEXANDER & ALEXANDER OF NEW YORK INC.,
New York, N.Y., June 16, 1982.

JOHN J. SALMON, Esq.,
Chief counsel Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: These comments are submitted on behalf of Alexander & Alexander. Inc., which provides consulting services to over 2,000 employee benefit plans.

Alexander & Alexander has previously submitted to you, in a letter dated June 1, 1982 from Mr. Charles E. Ginsberg, Manager of Research & Technical Services, our initial comments with regard to HR 6410. We would like to take this opportunity to enlarge and expand upon certain portions of our earlier comments with regard to this particular Act. Although we have reservations about each of the sections of the Act, as expressed in our earlier letter, we are particularly concerned with those sections dealing with the overall limits on contributions and benefits, and integration with Social Security. We continue to feel that passage of HR 6410 would seriously damage the private pension system at a time when, because of Social Security's funding problems, the President is urging the private system to take an even more active role in providing retirement income. Not only would the private system be seriously damaged, but we also feel that a fall-out effect would be a weakening in the individual savings of employees which currently takes place under employer-sponsored thrift and savings plans. The following outlines our specific concerns with these particular sections of the Bill:

OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

It is one thing to consider reducing the level of increases, which reflect continued inflation, or to even stop such increases altogether; it is quite another thing to not only stop the increases but at the same time to arbitrarily reduce the current limits to $90,000 for a defined benefit plan and $30,000 for a defined contribution plan. We would suggest that consideration might instead be given to limiting inflation increases to the smaller of the CPI or the overall U.S. average wage increase, as has also been suggested with regard to the cost of living increase for Social Security. If Congress feels that regardless of continuing inflation, any increase must be eliminated, then simply freezing the limits at their current maximum would seem to be sufficiently restrictive. It seems unrealistic to stop inflationary increases and in addition cut back benefits. Under reasonable actuarial assumptions, a 25-year old employee earning today in the $20,000 salary range and covered under a typical pension plan benefit formula will exceed this Bill's suggested pension limits by the time he reaches his actual retirement age. Proponents of the Bill might argue that at the time such pension becomes payable, the proposed limits could be increased. However, this fails to take account of the fact that the plan's future funded status at that time may already be severely strained since the plan will have been forced to fund for a much lower benefit under current IRS regulations. This will tend to jeopardize the security of those employees' benefits, thereby running counter to the very essence of ERISA. We would also note that congressional, civil service, and military retirement plans have a cost of living feature and we do not think that private pensions should be discriminated against in their efforts to protect participants against continuing inflation.

If a participant is covered by both a defined contribution and a defined benefit plan of the same employer, that participant's aggregate limit, which is currently equal to 140 percent of the separate limits otherwise applicable to each plan, would under this Bill, be decreased to 100 percent. In most instances, in order to comply, employers would simply cut back on, or terminate, their defined contribution plans which in many instances are thrift or savings plans. Since the thrift and savings plans generally provide some form of matching employer contributions as inducements for individual employees to save funds for their own retirement, this Bill would tend to reduce individual savings toward retirement.

HR 6410 also provides for additional reductions in the $90,000 limitation if retirement begins before age 65. The synergistic effect of combining an early retirement reduction with the 140 percent reduced to 100 percent, and the aribitrary reduction to $90,000, tends to produce limits which are much too restrictive for any type of realistic future benefit planning. We would note that for years this country's overall retirement planning policy has been predicated on the "three-legged stool" concept, i.e., Social Security, private pensions, and individual savings. HR 6410 now threatens to reduce two of the three legs of the stool, i.e., private pensions and employee savings toward retirement, and all of this at a time when benefit reductions are being considered for the third remaining leg, Social Security, in order to avert a long-range under-funding problem.

Finally, we are compelled to point out that the administrative cost involved in changing one or more qualified plans in order to meet the requirements of this proposed legislation is an additional burden upon employers who are still bearing the financial yoke of the extra adminstrative costs entailed by ERISA, which was passed eight years ago. At a time when President Reagan is attempting to reduce the paperwork and administrative costs necessitated by Government regulations, this Bill tends to not only increase administrative costs, but at the same time to reduce benefits to employees.

INTEGRATION WITH SOCIAL SECURITY

The integration of private pension plans with Social Security is a highly technical area. The current rules, although complex, are well understood by practitioners and all who administer them. In the past there has been a well-founded reluctance on the part of Congress or the Treasury Department to change these rules, due to the complexity of the topic and the legitimate debate that was engendered at the time of previous proposals. Currently, the National Commission on Social Security Reform is studying the nation's entire Social Security system, and will be making recommendations later this year. Certainly, when dealing with a subject as complex as the inter-relationship of private pension plans and Social Security, and the relationship between employee and employer contributions, it makes eminent good sense to resist effecting any changes in integration rules at this time, when it is likely that changes will be made in Social Security itself in less than a year! Let's at least address these problems in a logical order, first deciding what changes will be made in Social Security and once those are in place, then re-examining the relationship of Social Security and private pension plans, before making any changes in the integration rules.

Aside from the above, which we feel to be a most compelling argument, we would note that the Bill creates an arbitrary "safe harbor" but then throws the bulk of the interpretive problem to Treasury. This would have the effect of leaving the situation unclear as Treasury grappled with trying to come up with some new rationalization for practitioners.

We would also note that the proposed Bill's approach of reducing the employee's annual pension benefit by no more than an amount equal to the annual benefit that could be purchased with the aggregate Social Security taxes actually paid by the employer on behalf of the employee emphasizes individual equity, and fails to recognize the broader questions of social adequacy upon which Social Security is based.

Finally, we would note that the effect of the proposed integration rules would be to mandate different treatment for two employees working side-by-side after 1983, the one employee having previously been covered under the plan and the other employee having just entered the plan. The resulting administrative recordkeeping for the employer seems unnecessarily onerous. We would note again that not only is the effect of this section to reduce benefits but at the same time to make the employer pay excessive administrative costs while having employees' benefits reduced.

In summary, Alexander & Alexander feels that HR 6410 will substantially reduce benefits to employees, while imposing arbitrary, and in some cases irrational, restrictions on the private pension system. At the same time, this Bill would cause a substantial increase in administrative costs, thereby discouraging plan sponsors from continuing plans, and inhibiting the formation of new plans.

Sincerely,

A. M. D'ALESSANDRO,
Vice President and Division Manager.
HARPER L. GARRETT, Jr., F.S.A.,
Vice President and Director of Professional Services.

ALTAMIL CORP.,
New Orleans, La., June 7, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR SIR: The purpose of this letter is to offer comment on proposed House bill H.R. 6410, suggesting that you and the Louisiana delegation to the U.S. Congress fight this legislation that would only add to the cost of pension plan administration.

1. *I am concerned that any pension legislation of this magnitude could hinder, rather than encourage, the growth of the private pension system.*

Current public policy is clearly supportive of the private pension movement as an important element in the three-tiered system providing retirement income.

Two of the three tiers, social security and private savings, have been experiencing severe difficulties—social security because of changing demographics and the current economic environment, and private savings because of the impact of inflation on the ability of Americans to save.

President Carter and now President Reagan have established commissions to study the problems of social security. Congress has recently (1978 Revenue Act and 1981 Economic Recovery Tax Act) passed legislation to encourage individual thrift.

At a time when two of the three tiers are under extreme pressure, it seems unwise to legislate further restrictive action on the third tier—private pensions.

2. *I question whether the government can realize any significant amount of indirect revenues by making these changes.*

It is my understanding that a stated purpose of the proposed legislation is to realize additional government revenues.

The primary impact on employer contributions in plans of major corporations would be lower contributions for a handful of top executives (who are affected by lower benefit limitations). This will not generate significant revenue dollars for the U.S. government.

For example, drawing on my experience of administering Altamil Corporation's two pension plans, I find that no employee currently has projected age 65 pension benefits over the proposed $90,000 limit.

The other changes affecting corporate plans would require substantial corporate outlay in terms of design changes, new documentation, and explanations to employees, but would not necessarily decrease the overall level of tax-deductible employer contributions to these plans. In fact, for those employers who can afford to preserve their present plan formulas, the more restrictive social security integration rules would increase employer cost (and thereby decrease government revenues).

3. *I question whether any changes should be made in social security integration rules before larger issues concerning the social security system have been addressed.*

With the expectation that Congress will soon have to make significant changes in the social security system, it is premature to consider revisions in the manner in which private pension plans are permitted to coordinate with the public system. I urge Congress to address these issues in their proper and orderly sequence.

4. *I am concerned that attempts to limit loan privileges from plans utilizing Section 401(k) of the Code will defeat a portion of Congress' original intention of establishing such plans (provided for as recently as the Revenue Act of 1978).*

Among the important justifications for Section 401(k) is the broad national goal of encouraging individual thrift and deferring income until retirement. The extent to which this goal is achieved is important from a national perspective: the development of individual capital accumulation accounts should help ultimately to relieve pressure both on social security and on private pensions (especially relieving pressure to index such plans).

It should be obvious that the more a capital accumulation plan restricts accessibility of participant money, the less the eligible participants will utilize the plan for optional employee deposits.

To tax the proceeds of loans as income will have the simple negative effect of discouraging plan participation (especially when rules already exist requiring the orderly repayment of such loans).

I urge Congress to assess the need for the proposed legislation more closely. I feel strongly that the types of changes in this bill should not be the result of a hasty search for further government revenues and that it is far more important to reduce the growth in government spending than increase revenues.

Sincerely,

ROBERT T. HASS,
Pension Plans Administrator.

AMANA REFRIGERATION, INC.,
Amana, Iowa, June 14, 1982.

Hon. DAN ROSTENKOWSKI,
Committee on Ways and Means,
Washington, D.C.

DEAR SIR: As the plan administrator for a number of plans covering approximately 3,000 employees, I would like to express our concern regarding subject bill.

1. We believe that should this be enacted into law, there would be a marked reduction in the formation of new retirement pension plans, and extreme reluctance by plan sponsors to liberalize plans already in force.

2. This bill would require massive restructuring of existing plans in order to meet the proposed requirements with very costly expenditures of time and money. Also, it would enlarge the administrative burden in future years and, with all the current regulations we are burdened enough.

3. The bill as written suggests that disability programs, both short term and long term, would not allow benefits to be related to pay. This is grossly unfair since our employees contribute towards their disability insurance and want to relate it to their pay, and are willing to invest their current income to protect themselves against the catastrophe of a disability.

In summation, we ask that you seriously consider the ramifications of this bill as we feel it will do a disservice to employees who are investing in their retirement and various other insurance programs.

Sincerely,

ALLAN J. GLASFORD,
Sr. Vice President, Industrial Relations.

STATEMENT OF THE AMERICAN DENTAL ASSOCIATION

The American Dental Association appreciates this opportunity to present its views on H.R. 6410, the Pension Equity Tax Act of 1982. This legislation proposes sweeping changes in existing tax incentives which are designed to encourage participation of employers, employees and self-employed individuals in private pension plans. Without question, this is a complex and extraordinarily important bill that, if enacted, will have far-reaching consequences not only for retirement policy objectives, but also capital formation and the economy in general.

Since the issues addressed are so critical to the private pension system, we urge the Committee not to undertake action on this important legislative proposal until it can be more carefully studied, discussed, and debated for its impact on participants in qualified pension plans.

The American Dental Association strongly believes that any revisions in our private pension system should be designed to promote equality of treatment for all participants, including the self-employed, in retirement plans. In some instances, H.R. 6410 sets forth new initiatives, such as increasing present tax deferred contribution limits for Keogh plans, toward achieving this basic goal of parity. In other provisions, H.R. 6410 outlines proposals that would perpetuate, and in some cases create, discriminatory treatment of self-employed individuals in their retirement plans.

Basic equity in the treatment of private pension plan participants, regardless of the form of business organization under which the individual is employed, corporate or self-employed, was encouraged by this Committee in the Employee Retirement Income Security Act of 1974 (ERISA) and in the Employee Recovery Tax Act of 1981 (ERTA). The Association hopes that the following comments on the specific provisions of H.R. 6410 will be helpful to the Committee as it begins its extensive deliberations of the changes which are necessary to continue this trend toward parity. These suggested changes will help assure that existing and proposed new discriminations can be minimized by treating all self-employed persons and corporate employees in the same manner.

SECTION 2: CONTRIBUTION AND BENEFIT LIMITATIONS

Section 2 of H.R. 6410 would reduce existing maximum annual contribution and benefit limitations under corporate plans; repeal the annual cost of living adjustment to these dollar limits; reduce the maximum combined contribution limitation from 140 percent to 100 percent; require actuarial reduction for benefits commencing before age 65; and require that certain post-retirement medical benefits be taken into account in applying the dollar benefit limitations.

The Association strongly urges that the Committee examine the impact of these reductions in contribution and benefit limits on all participants in qualified plans. The Association hopes that the Committee will not eliminate cost of living adjustments for existing pension participants. Adjustments in contribution limits are necessary so that pension plans will protect retirees, whether self-employed or not, from the adverse impact of inflation.

The Association also urges members of this Committee to reject a reduction in the maximum combined contribution limitation from 140 percent to 100 percent. Such a proposal was properly defeated during consideration of the ERISA legislation and should be rejected now.

SECTION 3: LOANS TO PLAN PARTICIPANTS

Section 3 of H.R. 6410 would impose new limitations on loans by any qualified corporate plan to "key employees", who would include officers, persons with a five percent or greater ownership interest and the highest paid 15 percent of employees. Such a change would, in effect, extend present rules relating to H.R. 10 plans to other qualified plans.

While such a provision would not discriminate on the basis of the form of organization, it would create an inequitable situation between "key employees" and other employees without any justification for such a distinction.

Although we realize that the primary purpose for encouraging contributions to pension plans should be to provide adequate retirement benefits, the Association urges that the loan provisions be flexible enough to permit bona fide loans under carefully designated circumstances. In addition, the Association believes that any loan restrictions that may be adopted or deemed appropriate should apply equally to all employees regardless of compensation.

SECTION 5: SELF-EMPLOYED PLANS

The American Dental Association strongly endorses the increase in the limit on tax deferred, deductible contributions to H.R. 10 or Keogh plans from $15,000 to $30,000.

The Association also strongly recommends that the percentage of compensation limitation for Keogh plans must be increased from 15 percent to 25 percent, so that this proposed increase in the dollar limitation will not be illusory. Such a change also would provide greater parity between all pension programs whether they were sponsored by a corporation or not.

Along the same vein, the Association urges that the present $200,000 limit on maximum earnings that may be taken into account in determining contributions and benefits under H.R. 10 plans be adjusted to $400,000 to reflect the increase in Keogh contribution limitations. This same issue was discussed and an appropriate change was adopted in consideration of the Economic Recovery Tax Act of 1981. At that time, Congress increased the maximum earnings that could be taken into account from $100,000 to $200,000 so long as contributions at a rate of at least 7.5 percent were made for all employees participating in the plans. A consistent change also will be needed if the Keogh contribution limits are increased as they should be.

The Association strongly opposes the proposed extension of the special rules applicable to owner-employees under existing law to all self-employed persons whether they are incorporated or not. These special rules relating to plan participation, vesting, prohibited transactions, and other matters are overlapping, artificial limitations and no longer are necessary in light of the comprehensive requirements established by the ERISA Act of 1974.

The proposed changes in the bill with regard to these special rules merely extend and continue these discriminatory and unnecessary restrictions to all self-employed persons. The proper solution, in light of the existing ERISA requirements, would be to eliminate these rules entirely or at least provide a more reasonable set of uniform rules for all qualified plans, corporate or H.R. 10.

The Association also recommends adoption of a provision that would allow self-employed individuals participating in Keogh or H.R. 10 plans to act as their own trustees. Such a proposed modification would be consistent with possible trustee arrangements under other pension plans covered by ERISA.

SECTION 6: PERSONAL SERVICE CORPORATIONS

The American Dental Association strongly opposes Section 6 of the bill, which would extend discriminatory rules and contribution limitations from self-employed individuals to share-holder employees of professional or personal service corporations. The bill would specifically single out professional service corporations which provide services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics or consulting for arbitrary and discriminatory treatment. Establishing special pension rules because of the type of service provided by a professional corporation is without logical foundation. The bill further discriminates by improperly distinguishing between types of corporations.

Our interpretation of the bill indicates that it also discriminates unfairly against the "special" professional service corporations by reducing the percent of income limitations to 15 percent up to $30,000. The change which should be made would increase the allowable Keogh percentage limit to 25 percent, not to reduce the limit for certain professional corporations.

The Association believes that the basis for requiring equity in the treatment of corporate programs, whether of professional corporations or otherwise, has been firmly established by cases such as Kintner v. Commissioner (216 F 2nd 418). We feel the principles established in the past would apply to discriminatory provisions enacted now.

CONCLUSION

Mr. Chairman, the Association hopes that these comments will be helpful in your consideration of this significant proposed legislation.

Our hope is that this Committee will carefully evaluate this proposed legislation to determine if the provisions outlined in H.R. 6410 do in fact encourage equality of treatment of all pension participants, including the self-employed. The recommendations set out by the Association, in our view, will be helpful toward reaching the goal of eliminating inequities in existing pension plans, especially discriminatory provisions relating to self-employed individuals.

We thank you for your consideration of our views.

STATEMENT OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

The AFL-CIO appreciates the opportunity to state our views on H.R. 6410, "The Pension Equity Tax Act of 1982."

Congress is presently forcing low and moderate income workers to accept cutbacks in a variety of programs in order to reduce the budget deficit. Fairness requires that Congress also address the important role played by indirect tax expenditures which may unfairly benefit high income persons. Such a review may enable Congress to provide greater tax equity, to raise revenue, and to avoid some budget cuts in social programs.

H.R. 6410 strengthens the social policy on which the preferential tax treatment for pension plans is based. This policy assumes that tax subsidies are necessary in order to encourage broader pension coverage of workers and can only be justified if such plan benefits are distributed in an equitable and non-discriminatory manner throughout the workforce.

The general objectives of the bill are commendable. However, the AFL-CIO has serious concerns about some provisions of H.R. 6410 and believes that modifications are essential before the bill could receive our support.

SECTION 2. OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

The bill would reduce the ceilings set by present law on the maximum benefits and contributions under qualified pension and profit-sharing plans. The maximum benefit under a defined benefit pension plan would be reduced from the current $136,425 to $90,000 a year at age 65. The $90,000 would be reduced further for employees retiring before age 65. The maximum annual addition under a defined contribution plan would be cut from the 1982 level of $45,475 to $30,000.

These ceilings would be permanent unless ad hoc adjustments are made since the bill eliminates the current provision for inflation adjustments. In addition, companies could no longer provide overlapping deferred compensation and pension benefits totalling more than 100 percent of either limitation. Present law allows combined benefits from pension and profit sharing plans to reach 140 percent of present limits.

These limits would have little or no impact on collectively bargained pension plans with a normal retirement age of 65. However, under current law, the limit for defined benefit plans is applied to retirees age 55 and older. The bill would apply the $90,000 limit to benefits at age 65 and would actuarially reduce the limits for benefits paid prior to that age.

It is not uncommon for collectively bargained plans to provide full benefits before age 65, often as low as age 55, and, in these cases, the applicable benefit limit would be much lower due to drastic actuarial reductions. Using a typical reduction factor, this limit would be $27,000 at age 55. In addition, the bill repeals the annual cost-of-living indexing of the limits and inflation would soon, in effect, further reduce them. The result would be a growing and adverse impact on union negotiated pensions as a growing proportion of bargaining units are affected by the provision. We urge that the actuarial reduction be less and that the limits be indexed. This will enable pension bargainers to negotiate with confidence that the provision will not have a future impact on rank and file employees.

Actually, we see no reason for the bill to intrude into the sensitive area of labor-management relations when there is no compelling reason to do so. The purpose of nondiscrimination rules is to insure that employers and key executives do not design plans that provide themselves benefits and tax advantages not available to other employees. This is sound policy and we support the bill's objectives to strengthen it.

But these discriminatory concerns do not apply in a collective bargaining situation. A union as the representative of employees acts as a barrier against any efforts by employers or key executives to discriminate against other employees. We, therefore, urge the Committee to include a provision that collectively bargained plans are not covered if the plan is the subject of good faith bargaining between employer and employee representatives.

SECTION 3. LOANS TO PLAN PARTICIPANTS

At present, plans may make loans to participants on a uniform and nondiscriminatory basis if reasonable interest is charged and the loans are adequately secured. In effect, the bill would preclude loans to key employees (employees who are officers of the employer, 5 percent shareholders, or among the 15 percent of the highest paid employees) by treating the loans as taxable distributions.

In some loan situations, especially among small employers, some skilled workers such as electricians, machinists, and tool and die workers would fall within the 15 percent of highly compensated employees and loans to these workers would be subject to taxation. We don't believe it was the intention of the sponsors of this legislation to include such workers within its scope. These workers should not be the intended target of this legislation. Unlike high income people, they do not have sufficient income and assets to easily secure loans or to take care of themselves in retirement through investment and personal savings.

We urge that the definition of highly compensated employees be modified so that these kinds of anomalous situations do not occur. As suggested earlier and for the reasons stated, we also urge that this section not apply in collective bargaining situations where plans are the result of good faith bargaining.

SECTION 4. INTEGRATION WITH SOCIAL SECURITY

H.R. 6410 specifies principles for integrating qualified retirement plans with social security. Current IRS rules limit the extent to which social security taxes or benefits can be counted in testing a plan for discrimination. The bill properly tightens these restrictions by reducing employers' flexibility to coordinate retirement benefits with those that employees will receive from social security.

H.R. 6410 provides that no benefit could be reduced by benefits attributable to social security taxes paid by other employers or to those social security benefits unrelated in amount to the taxes paid. The bill also provides an alternative "safe harbor" rule under which a plan could choose a simplified benefit or contribution formula which need not take into account actual social security taxes paid by the employer on behalf of individual employees.

Presently, employers may "integrate" a pension plan—meaning they may count part of an employee's social security benefit when figuring how much that employee may get from the private plan. The reasoning behind integration is that it is not discriminatory to offset social security's benefit weighting in favor of low wage workers by providing a larger supplemental pension to higher paid workers.

Tax qualified plans are not permitted to discriminate in favor of officers, shareholders, or higher paid employees. But, under present law, the non-discrimination requirement can be met by a plan that is integrated with social security even though it provides no benefits for employees below the social security wage base. That wage base is now $32,400 and rises automatically in accordance with wages covered by social security. More than 95 percent of workers earn less than this amount.

Qualified pension plans are given special tax treatment because social security alone does not provide adequately for retirement and it is thought good social policy to encourage supplemental private pension plans. In view of this, lower paid employees should not be subject to exclusion from private pension plans on the ground that they are covered by social security. Contributions and benefits above the wage base can only be equitable if lower-paid employees receive adequate protection.

Integration plans are built on the erroneous assumption that lower paid workers can maintain an adequate standard of living if their percentage of pay from social security and pensions in retirement is the same as for highly paid workers. Lower paid workers need a greater percentage because it is applied to a low base pay, they have fewer assets and other sources of income, and because they have little or nothing in the way of nonessentials to cut back on.

Because integration formulas are highly complex, actuaries and pension consultants are sure to find "technical" problems with this section of the bill. We are certain any technical problems can be resolved. The AFL-CIO strongly supports these modest proposals which would help correct the inequities of pension integration and would benefit a great many workers.

SECTION 5 AND 6. SPECIAL RULES APPLICABLE TO PLANS GOVERNING SELF-EMPLOYED INDIVIDUALS AND CERTAIN EMPLOYEES OF PROFESSIONAL SERVICE CORPORATIONS

Keogh plan contribution limits

Self-employed people may adopt qualified retirement plans for themselves under current law only if the plans meet a special set of stringent standards. Not all of these "Keogh Plan" rules apply to broad-based partnerships in which no one person owns more than a 10 percent interest. The bill would tighten the rules governing plans covering the members of these larger partnerships. On the other hand, the current $15,000 annual limit on contributions on behalf of a partner or sole proprietor would be raised to $30,000 with a comparable increase in the pensions that could be provided under Keogh Plans.

We object only to the provision that raises the limit on the amount of money that can be contributed to a Keogh Plan. The bill would double the maximum amount of tax-free contributions self-employed persons are permitted to write-off for contributions to retirement plans. The AFL-CIO has always opposed the Keogh provisions because they are clearly and simply tax avoidance schemes for the prime benefit of high income, self-employed individuals.

Any benefits to low and moderate-income people are minuscule whereas those in higher brackets benefit from federal government subsidization of large proportions of their pension accumulations. Clearly a tax provision which conveys its benefits almost exclusively to the affluent can only be termed a loophole.

Professional service corporations

The bill would impose restrictions on the benefits that certain service businesses could provide for their employees who own stock in the employing business. If the corporation maintaining the plan performs services in the fields of health, law, engineering, accounting, architecture, actuarial sciences, performing arts, athletics, or consulting, its shareholder-employees would be treated for qualified plan purposes, as if they were self-employed. This would impose restrictions on the level of their benefits, their distribution and borrowing rights under their plans, and their companies' flexibility in plan design and investments that would be stricter than the standards for companies in other businesses.

We support this provision. Many small professional corporations, such as those created by doctors, lawyers, and engineers are abusing the tax shelter provided by pension plans at the expense of low paid employees, especially secretaries and nurses. The purpose of non-discrimination requirements is to insure that a plan distributes benefits fairly and that it not unduly benefit executives and highly compensated employees to the disadvantage of lower paid employees. In many professional corporations, the turnover among low and relatively low-wage employees is high and most never achieve vesting. Secretaries, nurses and receptionists come and go while the doctors or lawyers, who establish the plans, do not. If the latter leave, the plan is frequently terminated. In addition, the accrued values of the contributions of those who do not vest go to raise the benefits of the highly paid professionals who do qualify. Tax advantages for pension plans were intended to make pensions available to the workforce at large and not to provide tax shelters and economic benefits to highly paid professional employers.

SECTION 7. STATUTORY FRINGE BENEFIT PLANS

The bill would establish uniform standards for non-discrimination in a variety of tax-favored fringe benefits. If an employer's plan within these specified fringe benefits discriminates in favor of "key employees," those employees would be taxed on the contributions. Key employees include shareholders, officers, and the highest-paid 15 percent of the employees. The fringe benefit program would be considered discriminatory unless: (1) it benefits at least 70 percent of all employees and at least 85 percent of its participants are not "key employees" or (2) the IRS determines that it is not discriminatory. In the case of discriminatory plans, the bill denies tax exemption to key employees only.

The nation's tax system subsidizes numerous kinds of employee benefit plan arrangements. Those who benefit the most should not be those who are paid the most. This section attempts to force employee benefit plans to operate to benefit all workers and not favor the highly compensated by making it more difficult for employers and key executives to provide tax deductible benefits to themselves which are not equally available to other employees. We support this objective.

Modification should be made in the non-discrimination tests for collectively bargained plans. Unions negotiate fringe benefit packages tailored to the needs and wishes of the members in a particular bargaining unit—members who have sacrificed a portion of their wage increases for these fringe benefits. As pointed out earlier, when a union represents employees, there is an automatic check on the ability of employers and key executives to devise plans which discriminate against employees. Thus, it is appropriate that modifications be made so that the tests can be applied in a way which does not interfere with the flexibility and beneficial aspects of collectively bargained employee benefit plans.

SECTION 8. ESTATE TAX EXCLUSION FOR RETIREMENT SAVINGS

The Internal Revenue Code presently excludes from a decedent's gross estate those benefits paid to a beneficiary of a deceased employee which are attributable to employer contributions. There is no dollar limit on these exclusions. The bill imposes a $500,000 aggregate cap on such benefits applicable to estates of decedents dying after December 31, 1982.

We support the proposal. We fail to see how the public interest is served by subsidizing large estates of the wealthy.

In closing, we urge that our suggested modifications be incorporated in H.R. 6410. They are essential to avoid adverse and unintended effects on collectively bargained plans. With these changes, the bill would have AFL-CIO support and would more effectively achieve its objective to make the nation's private pension plans fairer and more beneficial to those covered by them. This is a goal long shared by the AFL-CIO.

STATEMENT OF THE AMERICAN GAS ASSOCIATION

The American Gas Association (A.G.A.) is a national trade association comprised of nearly 300 natural gas transmission and distribution companies serving approximately 160 million consumers in all 50 states. A.G.A. member companies account for approximately 85 percent of all gas utility sales in our nation.

A.G.A. does not support H.R. 6410 and believes that Congress should defer any action on this legislation until there has been an opportunity for closer scrutiny and analysis of the impacts and ramifications of the modifications contained in the bill.

In particular, A.G.A. believes that, while the intent of the legislation may be to reduce the tax deferral benefits of the highly compensated executive, the effect of the legislation may in fact be to cause a reduction in the benefits of mid- and lower-level employees. The modification in the cost of living adjustment (COLA) would have an adverse impact on the lower income wage earner over the long term.

With respect to the legislation's proposed modifications of the rules governing integration of pension plan benefits with Social Security benefits, it should be noted that the existing integration rules have been developed over a long period of time and are intended to ensure non-discriminatory pension benefits. This is a very complex subject and A.G.A. believes that closer scrutiny of the proposals is needed because it is ill-advised to risk pension benefit discrimination under untried benefit integration rules such as those proposed. In addition, inasmuch as the President's Social Security Commission is studying the current system, including the integration rules, it is unwarranted to make revisions of these rules before the results of the study are finalized.

A.G.A. also believes that H.R. 6410 betrays reliance on current law and is contrary to past and present congressional intent to encourage the establishment of fully funded pension plans. Indeed, many companies may abandon their corporate pension plans if the proposals set forth in H.R. 6410 become law.

H.R. 6410 is also a retrenchment of the principles set forth in the Economic Recovery Tax Act of 1981 (ERTA) which call for a greater reliance by individuals on personal savings and private pension plans for retirement funds rather than on the Social Security system. Contrarily, this legislation erodes the private pension system. Such a result is ill-advised particularly because it would shift the rank-and-file employee's reliance for retirement funds to an already burdened Social Security system.

Finally, H.R. 6410 generally undermines the congressional intent of many of the provisions of ERTA which were designed to enhance savings and investment incentives. In so doing, this legislation would have the effect of reducing the amount of money in the national capital pool from which growth and investment capital funds are now drawn. This, in turn, would put increased pressure on the money markets.

For these reasons, A.G.A. urges Congress not to enact the modifications set forth in H.R. 6410 and recommends that if any changes are to be made in the current pension laws such changes should be given due deliberation in view of the far-reaching effects of such legislation.

STATEMENT OF THE DIVISION OF FEDERAL TAXATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The American Institute of Certified Public Accountants is the sole national organization of professional CPAs. It currently has over 175,000 members. The Division of Federal Taxation of the AICPA has been authorized by the Institute's governing Council to speak on behalf of the Institute on matters relating to federal taxation.

We have reviewed H.R. 6410 and offer the following overview.

GENERAL

As a step in establishing equality of treatment of self-employed plans and corporate plans we support the increase in the deductible contribution limit to $30,000 for self-employed plans. However, additional changes are needed to approach substantive equality of treatment because of numerous other rules that discriminate against self-employed retirement plans. As stated in the most recent edition of our publication "Recommended Tax Law Changes," the Division of Federal Taxation believes that conformity in all respects between corporate plans and self-employed retirement plans should be enacted. Assuming an adequate comment and study time period were allowed, the Pension Equity Tax Act of 1982 presents an opportunity to achieve full conformity or to make very substantial progress towards it.

The direction of legislation the past forty years has been to encourage the formation of private pension plans. In retrospect, this trend has been fortunate due to the generally low savings rate experienced by the private citizenry and the precarious position of the Social Security system. We believe continuation of this favorable trend is important and any Congressional tampering with the momentum of this area may serve to confuse and alter the attitude adopted by the private sector to date. Specifically, it may affect businesses' commitment to continue this important and costly benefit. An area as important as adequate retirement income, at affordable cost, for the majority of Americans warrants clear and farsighted legislation. A bill which has not been adequately considered and subjected to acute professional analysis may prove to have extremely adverse and far reaching unintended consequences.

We do not believe the bill under consideration (H.R. 6410) has been given sufficient study or an adequate incubation period to form the needed data base. This is mandatory so a reliable evaluation of its long-range effects and impact on national objectives can be made. We recommend:

Postponement of its consideration until additional study and commentary are developed to fully understand its long-range implications; and

Such study and commentary be developed by an impartial and nonpolitical body of experts, similar to the President's Commission appointed to study the pension problem under the Carter administration.

SPECIFIC PROVISIONS

Our reaction to the specific issues raised by the bill is summarized as follows:

Benefit limitations.—There was a considerable amount of thought given to maximum limits by the initial ERISA committees, along with the concept of indexing such maximums to an acceptable, objective national yardstick to reflect the erosion of the dollar's purchasing power over time. We suggest a review be made of the considerations that went into these initial recommendations and the possible adverse effects of limiting them at this point, (e.g., the possible cutback or elimination of certain pension programs), be adequately deliberated.

Similarly, the 1.4 rule was formulated after in-depth reflection, and a decision to modify it should only be made after much further analysis and impartial, educated debate.

In statements of Tax Policy Nos. 6 and 9, the Division of Federal Taxation supports the concept of indexing the Internal Revenue Code to adjust for changes in the value of the dollar. We do not recommend a specific index, but believe that a single, generally accepted and consistently applied index should be used. Elimination of any automatic cost of living indexation mechanism for retirement contribution limitations is a serious backward move away from indexation and we oppose it.

Self-employed and personal service corporations.—As stated above, the increase in Keogh limits coincides with our belief that parity is desirable in corporate and noncorporate retirement plans. The extension of restrictive rules to personal service corporations is discriminatory and an inequitable suggestion. We believe any legislation should apply uniformly to all pension programs and not subject select segments of the private sector to arbitrary standards.

Extending the rules covering owner-employees to other self-employed individuals is a complex matter and should be studied in depth before changes are made.

Loans.—The flexibility afforded by loans to participants is frequently part of the overall lure of initiating a pension program. We believe limiting this provision will discourage the continuation or formation of plans, particularly in the small plan area, i.e., less than 100 participants.

We do not believe there is evidence of abuse in this area that warrants direct legislative attention; the monitoring ability of the Treasury and Labor Departments seems to have been working well. Under current law only arm's length, nondiscriminatory loans are allowed. These rules are adequate to prevent significant abuses.

Integration.—The rules concerning integration have been in need of review and probable revision for some time. It is a difficult area for most plan sponsors to fully understand and administer. We believe there is no logical basis for altering integration rules until the National Commission on Social Security Reform has issued its report due after the November elections, and the general future of the Social Security system has been formally addressed by Congress.

Uniform antidiscrimination rules.—We question whether the proposal for new uniform nondiscrimination standards for statutory fringe benefit plans would result in sufficient additional revenue to warrant the potential restrictive affect on coverage to employees, in particular the rank and file.

Estate Tax Exclusion.—Limiting the estate tax exclusion presents a contradiction to the liberalizing atmosphere created by the recent ERTA of 1981. It is important for legislation to create a consistent position in an area that requires so much preplanning on the part of individuals.

CLOSING COMMENTS

We believe it is worthwhile reminding Congress that the pension area is one of the mainstays contributing to capital formation. The future tax base of our nation is directly tied to the rate of today's accumulation of capital. Discouraging the formation of this "investment pool" seems rather shortsighted. There are an abundance of questionable tax-shelters proliferating in the economy that might be better challenged; both their current and future benefits to society are suspect. We believe legislation to raise current revenues should possibly be targeted at those tax-shelters that have less economic and social justification than does the private pension area.

The administration of pension plans has been an exceedingly time-consuming and expensive proposition for both the private sector and certain governmental agencies, particularly since the passage of ERISA. Placing significant added administrative burdens on plan sponsors should be avoided if at all possible.

We urge Congress to weigh thoroughly the short-term apparent advantages of this bill versus the long-term probable deleterious and possibly disastrous effects. We believe postponenment coupled with additional deliberation by qualified parties is in order.

STATEMENT OF THE AMERICAN MEDICAL ASSOCIATION

The American Medical Association takes this opportunity to comment on HR 6410, the so-called "Pension Equity Tax Act of 1982."

HR 6410 would make a variety of radical changes in the rules governing retirement pensions of self-employed individuals and corporate employees. With regard to corporate plans, it would: reduce the maximum contribution to a defined contribution plan by one-third; reduce benefits from defined benefit plans; and eliminate annual cost-of-living increases in these maximum allowances. The bill would have an even greater impact on "professional service corporations" by making their retirement plans subject to the same rules as Keogh plans. Thus corporate pension plans would be treated differently, with more stringent rules applying to professional service corporations. The bill would also double the amount of contributions allowable for self-employed persons under Keogh plans by increasing the Keogh plan annual contribution from $15,000 to $30,000. However, no change would be made in the wage base against which contributions can be made.

We believe that the proposal is extremely inequitable in the way it discriminates against shareholders and employees of personal service corporations. Furthermore, it would discourage employers from maintaining qualified pension plans which would be particularly detrimental to low and moderate income employees. We also see the proposal as adversely affecting economic growth in both the short and long term.

UNEQUAL TREATMENT OF PROFESSIONALS

The title of the bill, the "Pension Equity Tax Act of 1982," implies that a major purpose of the bill is to achieve equal treatment for all participants in qualified pension plans. In fact, the bill imposes unequal and inequitable treatment on professionals, their employees and certain other providers of personal service.

Under present law, qualified retirement plans for self-employed individuals (Keogh or HR 10 plans) are subject to much stricter limits on contribution and benefits than plans for corporate employees. Annual contributions under defined contribution Keogh plans are limited to the lesser of 15 percent of compensation or $15,000 compared to the lesser of 25 percent of compensation or $45,475 for corporate plans. Annual benefits under both Keogh and corporate defined benefit plans are limited to the lesser of a participant's average compensation for his high three years or $136,425. But the basic benefit which may be paid under a defined benefit Keogh is further restricted by the applicable percentage limitations contained in Sections 401(j)(2)(B) and 401(j)(3) of the Internal Revenue Code (the "Code"). These limits are so restrictive that, to the best of our knowledge, very few defined benefit Keogh plans have been established. Instead, individuals interested in a defined benefit plan will generally incorporate so as to be free of this restriction.

The bill purports to equalize treatment of self-employed individuals and corporate employees by increasing the limit for deductible contributions to defined contribution Keogh plans to $30,000 and by doubling to $200,000 to amount of compensation which may be taken into account under Section 401(j)(2)(A) of the Code in calculating the benefit under a defined benefit Keogh plan, while decreasing the corporate contribution and benefit limits to, respectively, $30,000 and $90,000.

These changes do not equalize the treatment of self-employed persons and corporate employees. Furthermore, the bill subjects shareholders in professional corporations to the Keogh plan limits on contributions and benefits and therefore discriminates against professional service corporations in an unjustified manner.

Under the bill, deductible contributions to defined contribution Keogh plans would remain subject to the 15 percent of earned income limitation in Section 404(e)(1) of the Code. Thus, a self-employed person or a professional earning less than $200,000 per year would be unable to make as large a contribution as an employee of a non-professional corporation with the same income. And defined benefit Keogh plans would remain subject to the Section 401(j)(2)(B) and 401(j)(3) applicable percentage limitations. In many cases, these provisions would limit the pension payale to a self-employed person to less than that which would be paid to a corporate employee with the same income over the relevant period. For example, a self-employed person or a professional with earned income of $100,000 per year who established a defined benefit Keogh plan at age 55 could be paid a pension of $25,000 per year at age 65. An employee of a non-professional corporation with the same compensation over the same period could be paid a pension of $90,000 per year under the bill's limits.

Under the present law, any self-employed person can achieve equality with corporate employees by incorporating his business or professional practice and adopting a corporate pension plan. The bill would remove this opportunity for professionals by applying the Keogh plan limits to corporations which perform services "in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics or consulting." Self-employed individuals in other fields, however, remain able to avail themselves of the corporate limits by incorporating their businesses. Thus, the bill for no apparent logical reason discriminates against professionals and their employees by denying them opportunities available to all other individuals, regardless of whether they are employed by others or in business for themselves. It would be unique to pension law to create a classification based solely on the "product" produced by the business.

This discrimination against professionals and their employees is further evidenced by the extension to "personal service corporations" of various restrictions presently applicable to Keogh plans contained in Sections 401(c) and (d) of the Code. Thus, professional corporations would be subject both to the restrictions which the bill imposes on all corporations and additional restrictions to which other corporations are not subject. According to the sponsor of the bill, Congressman Rangel, the extension of these restrictions to plans of personal service corporations is necessary to prevent discrimination against common law employees of such corporations (see *Congressional Record,* May 19, 1982, pages H2353–54). There is no reason to believe that the antidiscrimination rules currently applicable to corporate plans are inadequate to deal with any problems which do exist. And if the current plans are inadequate, the more restrictive rules should not be applied only to personal service corporations. There is no reason to believe that physicians, lawyers and other professionals are more likely to discriminate against their employees than incorporated plumbers, carpenters, professional writers and others to whom these restrictions are not applicable.

DISCOURAGING PENSION PLANS

A number of the provisions of the bill would encourage employers to refrain from adopting a pension plan or to terminate existing plans. Most important are the changes regarding integration with social security, which will substantially increase the costs of many plans. At the present time many companies, including major corporations, are experiencing reduced profit margins, or even substantial losses. There are already reports that some corporations are considering reducing pension benefits or terminating plans to improve profitability or reduce losses. It seems unwise and short-sighted to increase further the cost of providing pensions under such conditions.

Not only would the bill increase the cost of maintaining a pension plan, it would reduce incentives to establish or maintain one. It seems ironic that the bill would eliminate cost-of-living adjustments to pension benefits and contributions so soon after the Economic Recovery Tax Act of 1981 introduced indexing of tax rates. As tax rates decrease, the value of tax deferral under a qualified pension plan will also decrease. And if the inflation continues, the pension contributions and benefits allowed by the bill could become increasingly inadequate to finance the retirement of many, or even most, persons. This, in conjunction with the increased costs, will encourage many employers to forego fully funded qualified plans and look for other means of providing for retirement benefits or tax deferrals. Such a development would cause serious financial harm to the lower income employees the bill purports to protect.

A TAX INCREASE

In November of 1980 the American people presented a landslide electoral vote victory to Ronald Reagan. Part of President Reagan's mandate was based on his promise to reduce taxes. This philosophy, supported by the American people at the polls, indicated it was time to shrink the "government pie"—to reduce both government expenditures and government revenues so that the private market would have the added capital to finance needed capital investments and increase the supply of goods. HR 6410 is a tax-increase proposal that is inconsistent with the publicly supported Administrative philosophy to reduce or maintain at present levels the amount of taxes to which a person is subjected.

SAVINGS FOR THE FUTURE

By deciding not to tax certain income which is placed in retirement plans, the Congress has established a policy of encouraging individuals to save for their future needs when they have retired. Through a reduction in the maximum contribution to a retirement plan or with termination of qualified pension plans, the incentive for savings would be reduced. HR 6410 would create disincentives for retirement savings that would impact not only on professionals, but also on their employees. The bill affects private pensions at all income levels. Private pension plans help assure that there is less chance that individuals will require public assistance. Furthermore, to the extent that people are less prepared to meet their financial needs during retirement, it become more likely that the federal government may have to increase its public support activities for the elderly and it could lead to additional strains on the already overburdened Social Security system. We believe that Congress should continue to encourage, rather than discourage, private savings for the future. Already the percentage of income devoted to savings in this country is substantially lower than most other industrial nations.

CAPITAL ACCUMULATION

Pension plans are a long-term commitment of assets to savings. Pension funds are not usually volatile, short-term investments but solid long-term funds that accumulate over many years. Pension plan assets are often invested in such ways to support capital development, thereby increasing the resources available to finance economic expansion and support industrial growth. Experts agree that the American economy needs greater capital resources at the present time; it would not be prudent to reduce the amounts of savings contained in pension funds.

INCENTIVES FOR PRODUCTIVITY

It is a basic premise of the American free enterprise system that individuals should be entitled to maximize the economic rewards from their labor. The incentive to increase one's standard of living and economic well-being is what fuels a free enterprise economy and is a principal distinction between our economy and those struggling centralized planned economies which continually experience productivity and efficiency problems due to lack of financial incentive for people to increase their output. It is essential that the American economy retain the economic incentives to encourage people to undergo rigorous technical and professional training, and to work hard to produce quality goods and services in abundance.

QUESTIONABLE REVENUE-RAISING EFFECT

While not a stated objective of the legislation, its introduction at this time of high budget deficits may lead some to view it as a revenue-enhancement measure that could lead to reduction of budget deficits. In our view it is unlikely that the bill, taken as a whole, would yield any substantial federal revenues, if indeed any at all. First, the bill would raise deductible Keogh contributions to a maximum of $30,000 a year from the present $15,000. Lost revenues from this provision would offset increases from the other provisions. Secondly, those most affected by the bill's provisions are sophisticated businessmen and professionals who are sensitive to the tax implications of their investments. If pension vehicles become an unattractive investment for their funds, they would merely find alternative vehicles for sheltering income—possibly with less social value than pension plans—resulting in no net revenue gain to the federal government.

KEOGH LIMIT INCREASE

The bill provides for an increase in the maximum allowable annual contribution to a Keogh plan. We believe that self-employed persons who are not a part of a professional corporation or self-employed persons who are not a part of a professional corporation or employed by corporation should have similar opportunities for setting aside resources for retirement. Permitting an increased contribution would help to provide parity to those who choose to be unincorporated self-employed businessmen and professionals.

CONCLUSION

The AMA opposes the provisions of H.R. 6410 that discriminate against professional corporations and their employees and discourage pension savings. At a time when the President's Commission on Pension Reform has called for increased private sector pension savings, when the Social Security trust fund is on the brink of bankruptcy, when pension plan assets are being used to finance new home purchases and assist businesses with short-term cash flow problems, when the aging of the nation's population could lead to increased numbers of retired individuals in need of pension funds for support, it seems short-sighted to create disincentives and barriers to pension plan creation and operation. The provision increasing the Keogh contribution limits would accomplish in part the goal of creating parity between plans, and we support such an increase. Notwithstanding this provision, we must urge the Committee to reject H.R. 6410 because of its major discriminatory provisions. We suggest that the Committee study the entire scope of retirement plans, in both the private and public sectors and, if the goal is equality, fashion long-term reforms to provide parity for all workers, regardless of employer, in order to provide an opportunity for individuals to save while they are working for their retirement.

American Natural Resources Co.,
Detroit, Mich., June 17, 1982.

John J. Salmon,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

Dear Sir: American Natural Resources Company is a diversified energy company engaged in the exploration for, transportation, storage and sale of natural gas; nationwide motor freight; low-sulfur eastern coal mining and the construction and operation of the country's first commercial size coal gasification project. American Natural has over 11,000 employees covered by various qualified defined benefit and defined contributions plans. H.R. 6410. The Pension Equity Act of 1982, will have a broad impact on the qualified benefit plans of most major corporations in America. It is our belief that this proposed legislation in its current form is not in the best interest of either corporations such as American Natural or their employees. Careful study should be made of all aspects contained in this proposed legislation prior to taking any action on it.

Although we have not been able to fully examine all the implications of this Bill, American Natural wishes to express its concerns to the House Ways and Means Committee. First, we feel that H.R. 6410 will limit retirement benefits not only to the highly compensated employee but also to the rank-and-file worker, an action that we feel is unintended and contrary to the basic premise of ERISA. Second, American Natural is concerned that this Bill will cause additional burdens to be placed on the Social Security System by requiring it to replace some of the retirement income which could be lost by employees. Third, we are very concerned about the added administrative burden which will be placed on the corporation to maintain and administer plan amendments needed to conform existing plans to the proposed legislation. Finally, American Natural feels that this legislation will encourage employers to develop unqualified plans that discriminate in favor of senior level employees, another result of this legislation that reverses the benefit equity provided for under ERISA.

In view of the above, we offer the following general observations:

LIMITATION ON BENEFITS FROM AND CONTRIBUTIONS TO QUALIFIED PLANS

American Natural takes exception to the three-pronged attack on maximum post-retirement benefits proposed by the Bill. The imposition of (1) a 34 percent reduction in the dollar limitations, (2) the elimination of the annual cost of living adjustment to these limitations, and (3) a reduction in the limitation for multiple plans from 1.4 to 1.0, will seriously impact the benefits which many large corporations can offer to all of their employees.

American Natural, as do most corporate employers, feels employees should look to three main sources for post-retirement income: pension plan benefits, savings and Social Security. American Natural has tried to help the employee provide for the first two sources by offering a qualified defined benefit Retirement Plan and a qualified defined contribution thrift/Savings Plan. H.R. 6410, because it includes the reduction of the multiple plan limitation factor from 1.4 to 1.0, would severely limit the benefit provided by these two plans and force employees to look to Social Security to help make up the loss. Currently, American Natural would have only a few executives whose combined accrued annual pension benefit and Savings Plan contribution would be limited by the provisions of H.R. 6410. However, because of the elimination of the cost-of-living adjustment, in ten years more than 100 persons will be affected by these limits assuming only a 7 percent salary program. It can be seen that with such a rapid increase in the number of affected plan participants that the rank-and-file employees, as well as the highly compensated executive, will soon have their benefits limited.

These limitations, coupled with an employer's desire to maintain employee relations, will result in the introduction of many unfunded plans. This result is in direct conflict with the basic philosophy of ERISA which is to provide for a high level of benefit security.

The Bill requires an actuarial reduction in the benefit limits if an employee retires prior to age 65. American Natural feels that this is inconsistent with the provisions governing withdrawal of funds from defined contribution plans, such as a TRASOP or an IRA. These plans allow for an unincumbered benefit at age 59½ while H.R. 6410 would penalize a pension benefit payable prior to age 65.

KEY EMPLOYEES AND LOAN PROVISIONS

H.R. 6410 proposes to deny loans to a plan participant if the employee is considered a key employee. Any such person who requested a loan would have the funds considered a plan distribution. American Natural feels that this provision of the Bill is most harmful to rank-and-file employees. First, the Bill defines key employee as being anyone in the top 15 percent of the company payroll. This high percentage in many corporations includes many non-management personnel. Second, a loan provision in a defined benefit or defined contribution plan enables an employee to provide for such items as housing and education, yet maintain an adequate retirement benefit in the plan. At a time when the Federal Government is considering expenditure reductions in student loans, the further elimination of such a financial resource from an employee's grasp produces a severe financial hardship.

SOCIAL SECURITY

American Natural is concerned with the additional administrative burden placed on it by the Social Security offset provisions of H.R. 6410. The Bill proposes that the maximum benefit offset by Social Security be limited to that portion of the benefit provided for by the employer's contribution. If an employee has worked for the same company all of his life, this calculation is very easy to make, If, however, the employee has worked for more than one company, the employer will have to use tables provided by the Internal Revenue Service in order to correctly calculate the offset. These tables would have to be revised each year due to an annual revision to the Social Security benefit provided by its automatic cost-of-living adjustment. In addition, with the innumerable variations of employment history and Social Security participation, the calculation of a Social Security benefit offset will become more complex and require the accumulation of substantial data.

Of greater concern to American Natural is the additional burden which would be placed on the Social Security System by these benefit limitations. Retirees will be receiving a greater percentage of their overall retirement benefit from Social Security and therefore be more dependent on it. At a time when the bipartisan Social Security Commission is trying to determine ways to enable the financially strapped Social Security System to keep paying retirement benefits, legislation such as H.R. 6410 is totally improper.

In conclusion, American Natural reiterates its stance against H.R. 6410. The reduction of the benefit limits, the reduction of the combined plan factor, the elimination of a cost-of-living adjustment and the complexity of the proposed Social Security offset can only work to curtail the development of quality benefit plans for the country's working population.

Sincerely,

ROBERT A. WATERS,
Vice President, Finance.

AMERICAN RETAIL FEDERATION,
Washington, D.C., June 18, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR CHAIRMAN ROSTENKOWSKI: On behalf of the state retail associations in 50 states and the District of Columbia, and the 31 national retail associations affiliated with the American Retail Federation, we respectfully refer to the record of recent hearing on the Pension Equity Tax Act of 1982, H.R. 6410.

The Federation heartily endorses the statements and testimony of the National Association for Employee Benefits (APPWP, Inc.) and the ERISA Industry Committee in opposition to the legislation.

The purpose of this endorsement is to firmly establish the position thereon of the retail industry, while avoiding redundancy in the light of the short period of time during which the record on this legislation remained open for comment.

We appreciate your incorporating this letter into the record of H.R. 6410.

Cordially,

DONALD F. WHITE.

STATEMENT OF THE AMERICAN SOCIETY OF INTERNAL MEDICINE

The American Society of Internal Medicine (ASIM)—a federation of 51 state component societies representing more than 17,500 physicians recognized as specialists in internal medicine—takes this opportunity to comment on the Pension Equity Act of 1982, H.R. 6410. ASIM believes that H.R. 6410 would unfairly penalize the employees of professional corporations, and consequently opposes passage of this legislation in its present form.

Section 6 of the bill would establish an artificial distinction between the so called "personal service corporation" and other corporations. The pension plans of employees of these personal service corporations would be subject to certain rules applicable to plans of self-employed individuals while all other corporations would not be subject to these rules.

Specifically, personal service corporate plans would be subject to a 15 percent of earned income limit with regard to tax deductible contributions to defined contribution plans. In addition, the percentage limitation of Sections 401(j)(2)(B) and 401(j)(3) of the Internal Revenue Code would be made applicable to the pension plans of personal service corporations only. ASIM objects to this discrimination against employees of such corporations. The Society fails to see the justification for extending greater pension-related tax benefits to employees of certain corporations than to those of others.

This and other provisions of H.R. 6410 would reduce incentives for professionals to maintain or establish corporate pension plans—an important source of retirement security for lower income employees. ASIM urges the Committee to rethink this proposal so as to prevent financial harm to those individuals the bill purports to protect.

ASIM does support the increase provided by H.R. 6410 in the maximum allowable annual contribution to a Keogh Plan. This change would reduce the present discriminatory tax treatment between pension plans of self-employed persons and those of corporate employees.

Finally, ASIM objects to the rapid pace at which the Committee has been considering this proposal. After a mere 22 days from the date of introduction, the bill received a hearing in the full Committee. Since H.R. 6410 would make a variety of far reaching changes in the rules governing retirement pensions of both self-employed individuals and corporate employees, the Society thinks more time for careful consideration and reasoned debate would have been appropriate. ASIM urges the Committee to hold a second hearing after allowing adequate time for interested parties to analyze and formulate views on this matter.

In conclusion, ASIM urges that the committee take a more deliberate path in considering legislation of such importance and amend the bill to eliminate those provisions that unfairly penalize the employees of personal service corporations.

American Textile Manufacturers Institute, Inc.,
Washington, D.C., June 18, 1982.

Hon. Dan Rostenkowski,
Chairman, House Ways and Means Committee,
Washington, D.C.

Dear Mr. Chairman: The American Textile Manufacturers Institute, Inc. ("ATMI") is opposed to major changes being made to the present limits on pension and profit-sharing benefits which may be financed with deductible contributions by corporations, without adequate time being given for industry, plan administrators, and participants to analyze and comment on those changes which will be of particular significance to their retirement programs. Our concern is that action might be taken which would do irreparable harm to the private pension system in this country, especially in view of the relatively small amounts of additional revenue which would be generated by these changes.

PRESENT LAW

The present dollar and percentage limits on corporate retirement plan contributions and benefits are set forth in section 415 of the Internal Revenue Code, which was added to the tax law as part of the ERISA amendments in 1974. These limits are generally as follows:

1. In the case of a profit-sharing plan or other defined contribution plan, the annual contribution cannot exceed the lesser of $25,000 (subject to an annual cost-of-living adjustment using the last quarter of 1974 as the base) or 25 percent of the participant's compensation from the employer. Inflation and accompanying COLA since 1974 have increased the $25,000 figure to $45,475 in 1982.

2. In the case of a defined benefit plan, the limitation is on the benefit to be received rather than on the annual contribution to the plan, with the limit generally being the lesser of an annual pension benefit, beginning at age 55, of $75,000, or 100 percent of the participant's average compensation in his high three years of employment. The $75,000 figure is also subject to annual cost-of-living adjustment and, as of 1982, amounts to $136,425.

3. If both a defined contribution and a defined benefit plan are maintained by an employer, contributions and benefits up to 1.4 times those allowable under a single plan are permitted under the provisions of section 415(e) of the Code, which coordinate the annual limits whereon the same individual is covered by both types of plans.

Existing corporate retirement plan rules also generally permit:

(a) Loans to plan participants, if they bear a reasonable rate of interest, are adequately secured, provide a reasonable repayment schedule, and do not discriminate in favor of employees who are officers, shareholders or highly-paid.

(b) Integration with Social Security under complex IRS rules which generally assume that retirement benefits under the Social Security system are attributable to the employer's contributions to the extent they are not directly attributable to the employee's own contributions.

(c) Exclusion from gross estate of a deceased individual under a qualified plan or annuity of benefits payable to beneficiaries (other than the executor of the deceased).

THE BILL

H.R. 6410 would make major changes in all the above areas:

1. The annual dollar limits would be decreased to $30,000 for defined contribution plans (the equivalent of $16,500 in 1974 dollars) and to $90,000 for defined benefit plans (the equivalent of $49,500 in 1974 dollars).

2. The COLA or cost of living adjustments to the dollar limits would be eliminated for both defined contribution and defined benefit plans.

3. The 1.4 times the single plan limit for an employee participating in both a defined benefit and a defined contribution plan would be replaced by a provision requiring the maximum benefit payable under a defined benefit plan to be reduced in proportion to the amount of the benefit which was funded through the defined contribution plan. Thus, the combined limit would be 100 percent rather than 140 percent of the otherwise applicable limits.

4. As noted above, under present law the dollar limit in 1982 on benefits under a defined benefit plan is an annual benefit of $136,425, beginning with retirement at the age of 55. Under the bill, if the retirement benefit begins before age 65, the proposed $90,000 limit (replacing the existing $136,425) would be reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 65.

5. Loans to key employees from qualified corporate retirement plans would be treated as taxable distributions to the employees, with key employees being generally defined as officers, shareholders having more than a 5 percent interest in the plan sponsor, and employees who are among the highest paid 15 percent of the employer's employees. Also, any employee electing to defer amounts pursuant to a qualified cash or deferred arrangement under a qualified plan would be treated as a key employee for purposes of taxing to him as a distribution amounts borrowed from the salary reduction pension plan or the cash-or-deferred profit-sharing plan.

6. Social Security integration rules would be significantly altered so that most employers having integrated plans would have to provide either substantially greater benefits with respect to that portion of an individual's compensation that is equal to or less than the Social Security taxable wage base (in 1982, $32,400), or significantly reduce retirement benefits with respect to that portion of compensation in excess of the Social Security taxable wage base. For example, under the existing integration rules, for 1982 a corporate profit-sharing plan may provide for employer contributions of up to 7 percent of compensation in excess of $32,400 without allocating any contributions to employees earning $32,400. Under the bill, the 7 percent figure would be reduced to 5.4 percent of compensation, on the theory that 5.4 percent is the rate of the employer's OASDI contributions allocated on compensation up to the Social Security taxable wage base. Thus, unless the employer is to significantly increase its total profit-sharing contributions for all employees under the plan, the bill would require in 1982 a 22.86 percent reduction in the profit-sharing plan contributions attributable to earnings in excess of $32,400 (7 percent down to 5.4 percent). This rationale would also be applied to produce even more significant changes in the defined benefit plan rules.

7. Under the bill, the estate tax exclusion for distributions from qualified plans, which is now unlimited, would be changed to an aggregate $500,000 exclusion from the decedant's gross estate.

8. Uniform statutory non-discrimination requirements would be imposed for existing statutory fringe benefits, such as group legal, day care, etc., and extended to the much more significant areas of health insurance and group term life insurance, where worker coverage is already practically universal.

In addition, H.R. 6410 would raise the level of deductible contributions to plans benefitting self-employed individuals (so-called H.R. 10 plans) and would make the special more restrictive rules applicable to plans covering self-employed individuals generally applicable to plans of professional service corporations.

On June 10, 1982, the Treasury Department submitted to the Ways and Means Committee estimates of the revenue effect of the provisions of H.R. 6410, indicating that they would increase revenues by $19 million in fiscal year 1983, by $422 million in fiscal year 1984, and by $979 million in fiscal year 1985.

ATMI POSITION

In the short time available since the introduction of H.R. 6410, the great majority of ATMI's membership has not had the opportunity to analyze in detail the impact on their retirement plans of the sweeping changes the bill would make to present law. From those members who have contacted us to express their deep concern, however, it appears that the textile industry will generally have serious problems with four provisions of the bill:

1. The proposed reduction of some 34 percent in the maximum dollar limitation now in effect for tax deductible contributions to qualified plans.

2. The proposed elimination of annual cost-of-living adjustments in determining the maximum contribution allowable.

3. The substitution of new Social Security integration rules that significantly favor lower-paid employees as contrasted to present rules that allow proportionately more private retirement benefits to be provided for middle and higher-paid employees.

4. The harsh taxable distribution treatment accorded all loans from qualified plans to key employees, even in clear hardship situations, as well as the characterization of all employees electing cash or deferral or salary reduction options as key employees for this purpose to the extent they borrow funds from such plans.

ATMI recognizes that the determination of appropriate dollar limits on contributions and benefits under qualified plans is a value judgment and that reasonable men and women may differ as to the proper level. Obviously, the limit should not be so small as to eliminate most of the tax incentive for establishing qualified plans. In the present situation, Congressman Rangel believes that his $30,000 and $90,000 amounts for tax deductible pension plans "are entirely rational and defensible limits", and Assistant Treasury Secretary Chapoton stated recently, without citing his source of information, that "there is a growing belief that the level of benefits which may be provided to one individual through these tax-favored plans is simply too high". On the other hand, the tax-writing committees in 1973 and 1974 considered many of the proposals and arguments now being made by those who are pressing for drastic restrictions on the amount that can be deducted on behalf of any individual in the case of corporate contributions to qualified pension and profit-sharing plans. For example, then Ways and Means Committee Chairman Al Ullman, in a discussion on the House Floor on February 26, 1974, explained the specific dollar limits provided by the 1974 ERISA legislation as being "designed to avoid abuse of the favored tax treatment to finance extremely large pensions". He went on to say that the ERISA limitations were intended to be "generous enough to permit substantial retirement benefits which are adequate judged from any reasonable standard".

What is it that makes the dollar limits which were considered reasonable by Congress when enacted in 1974 somehow excessive when viewed from the perspective of Congressman Rangel and Assistant Secretary Chapoton eight years later? Is it the original 1974 limits set by Congress of $25,000 and $75,000, which have grown because of inflation to to-day's level of $45,475 and $136,425? (In the textile industry, for example, where profits are highly cyclical and substantial portions of executive compensation are frequently paid in the form of bonuses dependent upon profit levels, the lower dollar limits in H.R. 6410 will have significant impact on those executives who are paid well in good years but much less in poor years.) Is it the fact that there are automatic COLA adjustments to the original limits, which in 1974 Mr. Ullman told the House were of vital importance to maintain the real value of retirement benefits? Or is it the fact that the COLA adjustments under ERISA are tied to the Consumer Price Index which many economists and others now believe has overstated actual wage inflation occurring since 1974? Or is it the 140 percent factor applied to the limitation amounts when combined defined contribution plans and defined benefit plans are encountered? Or is it the fact that the annual limitation for defined benefit plans is an annual limitation of $75,000 at age 55, rather than at age 65, with an actuarial cutback in the pension benefits payable if an individual retires before age 65?

Neither Mr. Rangel nor Mr. Chapoton tells us which of the above features of existing law concerns them the most, although Mr. Chapoton has testified in the hearings on H.R. 6410 that "some method should be used to prevent a significant erosion [of 'realistic limits on allowable contributions and benefits'] in real dollar terms of inflation over a long period of time".

Unfortunately, the revenue estimates for H.R. 6410 released by Treasury do not tell us how much of the projected increase in revenue for fiscal years 1983, 1984, 1985 and 1986 is simply attributable to not making COLA adjustments. The Committee obviously needs such information before it concludes that substantial revenues can equitably be raised by further cutbacks across the board on deductible corporate contributions to qualified retirement plans on behalf of their higher-paid employees. ATMI believes that those who would change the existing dollar limits should be asked to explain in more detail what makes the present dollar limits, determined by Congress in 1974 to have been reasonable, somehow unreasonable in 1982. This does not mean, of course, that some features associated with the present dollar limits may not need modification.

For example, if deemed appropriate after further study, the present 140 percent cap on combined defined contribution and defined benefit plans might be adjusted in some fashion, if rank and file employees can be adequately protected. In like fashion, after considering all industry comments, Congress may conclude that the defined benefit limit should be based on a higher normal retirement age than 55, with appropriate actuarial reductions on the limit for early retirement. In addition, if the annual COLA adjustments under present law are found to be excessive, a revised COLA formula could be substituted for the future, possibly based upon the recommendations expected this Fall from the bipartisan Social Security Commission for handling cost-of-living adjustments under the Social Security System. Consideration of proposals for changing the existing Social Security integration rules should also be deferred until the Commission files its report.

The important point is that Congress should carefully review each feature of existing law which proponents of change find objectionable to make sure that any legislation is merely corrective in nature and that it does not unduly discourage formation, continuance, and improvement of private retirement plans. Precipitous Congressional action, motivated by the desire to include pension reform in this summer's expected major tax increase bill should be avoided. The subject matter is too important, and the potential revenue increase far too small to warrant hasty action that could seriously damage this country's private retirement system. Moreover, the enormous amounts of time and effort and money that will have to be spent by plan sponsors and plan administrators to amend plans, change computer programs, notify affected participants, etc., if the vast changes being contemplated are enacted, certainly suggest that for reasons of extraordinary administrative burdens alone, sweeping changes in this important area should not be legislated unless absolutely necessary; it must be realized that these administrative costs, which probably are not included in the revenue projections, may well wipe out any revenue gains in the short run and convert them into revenue losses.

As for other proposals included in the bill, ATMI believes that considerably more study is needed before statutory non-discrimination rules are provided with respect to statutory fringe benefits such as employer provided group term insurance and insured accident and health plans. Specifically, the Internal Revenue Service should prepare a report on the nature and extent of discrimination problems that may exist, with a view to seeing whether any significant problems exist and whether they can be handled administratively, before Congress is asked to enact broad legislation that can only add significantly to the staggering paperwork problems industry faces in filing endless Government-required reports.

ATMI has no objection to the proposed increase in the dollar limits applicable to H.R. 6410 plans, provided it is not used as an excuse and as a justification for cutting back on the dollar limits for corporate plans.

ATMI takes no position at this time on the estate tax exclusion proposal included in the bill, other than to note that the effective date of any change that may be made should give adequate time for affected participants to adjust to the new rules by making appropriate changes in their estate plans. The effective date in the bill—applicable to decedents dying after December 31, 1982—would not appear to provide sufficient time for transition to the proposed new rules.

Respectfully submitted,

W. Ray Shockley,
Executive Vice President.

American Thread,
Stamford, Conn., June 11, 1982.

John J. Salmon,
Chief Counsel, House Ways and Means Committee, 1102 Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: My responsibilities at American Thread include the design and administration of pension and other employee benefit plans. I write to sound a loud note of caution concerning H.R. 6410, The Pension Equity Tax Act of 1982.

A careful reading of detailed analyses of the provisions and implications of this bill leaves me at a total loss as to why anyone would propose it, let alone consider it in its present form. I cannot conceive of any legislation that would require more plan revisions and employee disruption for less positive results. Indeed it reads as though disruption is its primary intent. If ever a bill should be subjected to informed cost/benefit analysis, this one heads the list.

As written, it would adversely affect the future benefits of a far larger population than the highly paid. The likelihood is that it would increase employer contributions, not reduce them, for individual plans, to say nothing of the tremendous administrative costs it would impose. Along the way it would dismantle long term disability plans as we now know them. It would erode employee investment in thrift plans and, most important, seriously set back total retirement income provided through the private sector. All this at a time when Social Security appears under attack.

Please give H.R. 6410 the going over it deserves. Better yet, put it on the back burner for study on another, more rational day.

Yours truly,

CHARLES T. HUTCHINSON, *Vice President.*

AMERICAN TRUCKING ASSOCIATIONS, INC.,
Washington, D.C., June 17, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The American Trucking Associations, Inc. (ATA) appreciates the opportunity to present its statement on H.R. 6410, the Pension Equity Act of 1982. ATA is the national trade association of the trucking industry which represents the common, contract and private carriers of freight in interstate commerce. ATA members are interested in H.R. 6410 since a large segment of our membership provide pension and welfare plans.

The proposed legislation raises important, complex and far-reaching issues of both social and tax policy. In addition to other results, H.R. 6410 substantially would reduce the maximum contributions to and benefit from most qualified retirement plans; it would eliminate the indexing of those maximums for future cost-of-living increases; it would require amendment of all plans integrated with Social Security; and it would extend nondiscriminatory requirements to group term life insurance and insured medical plans. In agreement with a position paper prepared on behalf of the business community, ATA opposes the proposed legislation for reasons set forth below.

Section 2 of the bill would drastically reduce the limits on contributions and benefits established by ERISA after thorough Congressional consideration and debate. Changing these limits may have far-reaching, detrimental effects not contemplated by this bill. For example, if one of the pruposes of H.R. 6410 is to increase tax revenues, this end will not be accomplished because employers will adopt other forms of deferred compensation (i.e., non-qualified supplemental pension plans) which will provide employers with the same taxable deductions when the benefits of the nonqualified supplemental pension plans are paid. Some other problems that this section of the bill would create include:

1. Because retirement plans are subject to elaborate nondiscrimination requirements, the pensions provided to lower paid individuals are usually based upon the pensions provided to more highly compensated individuals. Reducing the limits for the more highly compensated individuals will reduce pensions for rank and file employees especially in small businesses.
2. Elimination of cost-of-living adjustments will, over time, adversely affect all employees. Governmental plans, such as the Congressional, Civil Service and military plans, have such cost-of-living indexes. The private pension system should not be treated differently.
3. Required actuarial reductions for benefits before age 65 will significantly reduce benefits for all employees. Comparable reductions are not required in programs such as Civil Service.
4. The cutback in the overall benefit limitations, especially the "1.4 rule," will cause the termination of numerous plans benefiting rank and file employees. These plans will usually be the thrift or savings plans that particularly benefit rank and file employees.
5. Reductions in coverage under the private pension system will result in further pressure on the Social Security system. Congress should alleviate rather than increase the Social Security burden.
6. Private pension systems constitute a major source of private investment capital. Reductions in benefits will substantially reduce the growth of that pool of capital.
7. Limiting benefits will place smaller companies at a disadvantage in hiring and retaining talented employees. Domestic companies will also be at a disadvantage

compared to foreign companies, which studies show already provide more generous benefits.

8. Employers, especially those maintaining more than one plan, will have to amend their plans. The administrative costs and burdens will adversely affect all employees.

Section 4 of the bill contains a complex system to integrate Social Security and private plan benefits which would be costly and difficult to administer. The existing rules have been developed after extensive analysis by the Internal Revenue Service. A number of problems will result from these changes:

1. Increasing costs and changing well established integration rules will cause numerous plan terminations. The impact of these terminations will be largely felt by rank and file employees and will further increase the burden on the Social Security system.

2. Long-term employees would receive proportionately smaller pensions than short-term employees under the proposed integration rules. The pension system should encourage employment stability.

3. The National Commission on Social Security Reform is currently studying Social Security and its relation to the private pension system. The Commission will conclude its study this December. Legislation in this complex area should be deferred until the issue has been fully examined.

Section 7 of the bill would establish new nondiscrimination standards for many forms of statutory fringe benefits, including well established benefits such as health insurance and group life insurance. Numerous problems will result from these changes:

1. By effectively limiting benefits for more highly compensated individuals, the bill will result in benefit cutbacks or elimination of benefits for rank and file employees in important areas such as life insurance coverage.

2. By requiring equal dollar coverage for health insurance, the bill will greatly inhibit the expansion of health coverage to rank and file employees.

3. Existing rules on life and health insurance have been responsible for the extension of coverage to a broad segment of the work force. Restricting these provisions may have a highly detrimental effect on this important coverage.

4. No justification has been presented for changes in the long-established rules that currently exist. Underwriting and state law requirements prevent the occurrence of abuses.

5. The proposed rules are unfair by not taking into account compensation differences in long and short-term disability plans.

6. The requirements of allocating income in discriminatory plans can be administratively overwhelming, especially for large employers.

For all of the reasons set forth above, ATA is opposed to H.R. 6410. We request that it be included in the present hearing record of H.R. 6410.

Sincerely,

BENNETT C. WHITLOCK, Jr., *President.*

ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION,
Dallas, Tex., June 10, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR SIR: The purpose of this letter is to enter our formal statement into public record regarding House Bill H.R. 6410.

I am the General Counsel and Corporate Secretary of Annunity Board of the Southern Baptist Convention, 511 N. Akard, Dallas, Texas, 75201 (214-714-9611). Annuity Board of the Southern Baptist Convention is a denominational board which has administered for the past 65 years denominational employee benefit and relief programs for churches, agencies, institutions and other organizations within the bounds of the Southern Baptist Convention.

We want to focus our remarks at this time to matters of pension equity that we feel are inadequately addressed by the Pension Equity Tax Act of 1982 (H.R. 6410), yet which should be addressed by the Ways and Means Committee.

Of particular importance as equity issues in the context of pension legislation are the provisions of H.R. 5067 sponsored by Congressmen Jim Wright of Texas and Barber Conable of New York.

On May 19, 1982, Deputy Treasury David Glickman presented testimony in the Senate Finance Committee that generally supported the contents of S. 1910 (an identical companion bill to H.R. 5067) sponsored by Senators Bentsen, Dole and Chafee.

The provisions in H.R. 5067 are supported by the members of the Church Alliance for Clarification of ERISA, which is composed of members of over 27 mainline religious denominations.

We would submit that in light of Revenue Ruling 82-102 issued on May 17, 1982, there is an urgent need that legislation having the provisions of H.R. 5067 be passed to create pension equity and resolve many technical problems that hinder many ministers and denominational workers from accruing adequate retirement benefits.

An added consideration with respect to the provisions of H.R. 5067 is that such provisions would involve a minimal revenue impact.

We respectfully would urge the committee to hold hearings and favorably report H.R. 5067.

Very truly yours,

GARY S. NASH,
General Counsel and Secretary.

THE ARIZONA BANK,
Phoenix, Ariz., June 14, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: I am writing on behalf of The Arizona Bank to oppose the passage of H.R. 6410, The Pension Equity Tax Act of 1982, introduced by Representative Rangel in the House of Representatives.

The changes proposed in H.R 6410 are basic, structural changes which would require the amendment and redesign of virtually every qualified employee benefit plan maintained under Section 401(a) of the Internal Revenue Code, including plans maintained by corporations, such as the Bank, which are major employers.

It has been less than eight years since the Employee Retirement Income Security Act of 1974 (ERISA) was enacted. That legislation made basic changes in the manner in which employee pension benefit plans were regulated. To comply with ERISA, employers spent millions of dollars in man-hours and professional consulting fees. If enacted, H.R. 6410 will have a similar effect; the Act will require the redesign of plan benefit formulas, changes in the tables used to calculate benefits, modification of existing group insurance programs, and changes in the procedures for the adminstration of benefit plans. Such changes will result in substantial costs to the employers who maintain such plans and will not raise a significant amount of revenue.

H.R. 6410 appears to be based in the supposition that privately sponsored employee benefit plans are simply tax shelters for an elite few. The bill ignores the fact that the vast majority of private employee benefit plans, whether maintained as pension plans or as profit-sharing plans, are legitimate benefit programs designed to provide either a retirement income supplement to faithful, long-term employees or to encourage employees to accumulate capital for retirement and other bona fide purposes. Each type of plan serves a different purpose and meets different needs; the design of The Arizona Bank's employee benefit plans illustrates this.

The Bank has maintained both a profit-sharing plan and a pension plan for its employees for more than 20 years. The profit-sharing plan is a savings plan which covers all employees of the Bank with one year of service. The plan is designed to encourage employee thrift by matching employee contributions with contributions made by the Bank from its profits. The plan allows employees to withdraw their own funds and Bank funds subject to certain penalties. The plan also allows hardship withdrawals in certain situations in which an employee is faced with financial difficulties, for example, sending a child through college, covering losses resulting from an uninsured property loss, or an unexpected major uninsured illness. Contributions on behalf of employees under this plan have never approached the maximum amount permitted by law, and are not likely to.

The Bank's pension plan, on the other hand, is designed to replace, along with Social Security, a portion of an employee's income at retirement. This income replacement feature is designed so that an employee is not left at retirement with a drastic reduction in income and no source of income other than a Social Security stipend. The plan, together with Social Security, replaces a uniform percentage of compensation for all employees. The maximum benefit payable under the plan to any employee, including the highest paid executive, is not available unless the employee has 30 years of service; if an employee retires before completing 30 years of service, the employee's benefit is reduced pro-rata. If a participant retires early (prior to age 65) the pension paid is actuarially reduced to reflect the fact that payments are likely to be made over a longer period. As a result few, if any, employees are paid the maximum benefit; those who are, have worked for a considerable period of time to earn that benefit. Finally, the retirement benefits which are provided seldom keep pace with inflation, even when post-retirement benefit increases are taken into account. Thus, retirement benefits which today appear to be large over time wind up as moderate, sometimes even inadequate, after inflation has taken its toll.

The Bank's employee benefit plans are similar in design and operation to plans maintained by many larger employers throughout the United States. H.R. 6410 fails to recognize the basic legitimacy of such plans or to encourage such plans.

H.R. 6410 does not come to grips with any of the realities I have described above, but instead tampers with the method in which the basic benefit structure works, particularly its relationship to the existing Social Security system. The present system has worked well for a number of years; H.R. 6410 does nothing to improve the existing system and probably harms it.

The Arizona Bank strongly opposes the passage of H.R. 6410. If legislation is needed to correct particular abuses, the Bank urges that Congress identify the particular abuse to be corrected and design specific legislation to correct the abuse. Congress should avoid enacting hastily drawn and overbroad legislation, such as H.R. 6410, which has the potential to affect adversely the design and operation of every tax-qualified pension and profit-sharing plan maintained by the private sector.

Very truly yours,

DON B. TOSTENRUD,
Chairman of the Board and Chief Executive Officer.

STATEMENT OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

The Associated General Contractors of America (AGC) represents more than 30,000 firms including 8,500 of America's leading general contracting companies which are responsible for the employment of more than 3,500,000 employees. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial, and municipal-utility facilities. We appreciate this opportunity to submit written testimony regarding the Pension Equity Act of 1982 (H.R. 6410).

AGC is opposed to H.R. 6410 because the legislation would reverse this nation's long-standing policy of encouraging private retirement and fringe benefit plans. The Employee Retirement Income Security Act of 1974 (ERISA) was enacted to enhance the role of the private pension system as a necessary supplement to public retirement benefits. H.R. 6410 would curtail the growth of private plans which are necessary to provide adequate retirement income. The severe limitations imposed on private pension programs by H.R. 6410 will inevitably lead to attempts to expand government sponsored "pay-as-you-go" programs such as social security which have consistently shown poor fiscal performances due to the lack of private business principles in their administration. In short, H.R. 6410 will encourage plan terminations, discourage new plan formation, substantially increase administrative expenses, put greater pressure on social security, and adversely affect the supply of investment capital.

The following are specific criticisms of H.R. 6410 we have identified:

LIMITATIONS ON CONTRIBUTIONS TO AND BENEFITS UNDER QUALIFIED PLANS

ERISA created present Internal Revenue Code section 415 which imposes limits on contributions and benefits to qualified plans. Contributions and benefit limitations were indexed to keep levels sufficiently high to provide adequate funding for a realistic private pension system to supplement public programs. The drastic cut in maximum levels for contributions and benefits and the elimination of the indexing mechanism negates and reverses this basic policy.

In regard to maximum contributions and benefit amounts it must be remembered that these maximums are optional. In industries which have traditional cycles of prosperity and decline, like construction, maximum annual amounts are often not reached due to the lack of sufficient funds. During prosperous periods maximum contributions are made to make up for poorer economic periods. Lowering these amounts therefore has a more dramatic impact on cyclical industries than others.

This impact is further compounded by the elimination of indexing which will prevent the maximum levels to approximate themselves in economic value over time. In addition, cutting contribution and maximum benefit levels for higher paid employees would result in benefit reductions for all employees.

Limitations under multiple plans proposed by H.R. 6410 to restrict benefits to preretirement income ignore the tax motivated behavior sought by the variety of plans eligible for tax favored status. The bill would lower 1.4 limitation for combinations of defined contribution and defined benefit plans to 1.0. The policy reasons for offering different types of plans and goal of providing secure retirement benefits will be undercut by the bill.

The policy of encouraging early retirement by providing benefits to employees before reaching normal retirement age is undercut by the H.R. 6410 requirement of an actuarial reduction of retirement benefits. This policy will have the effect of reducing senior position availability in many firms, complicate management transfers from one generation to another in family operated businesses, and impinge on an individual's freedom of choice of terminating a working career.

LOANS TO KEY EMPLOYEES

Under current law, qualified plans generally may make loans to plan participants if the loans bear an adequate rate of interest, are adequately secured, provide a reasonable repayment schedule, and are available on a nondiscriminatory basis. H.R. 6410 would treat loans to certain key employees as distributions while apparently allowing loans to be made to non-key employees. While certain abuses alleged by the Treasury Department may occur as a result of certain loans made in a sole shareholder plan, creating a class of employees subject to a discriminatory anti loan rule is not an appropriate remedy. Creation of a class of individuals who do not enjoy the same benefits of plan participation as other participants cannot be justified by a possible abuse of loans by a limited number of individuals. If such abuses occur they should be specifically addressed without limiting the rights of all employees within a certain class.

INTEGRATION WITH SOCIAL SECURITY

One of the most complex issues raised by H.R. 6410 is the integration of plan contributions with the social security system. It is well known that the current bi-partisan Social Security Commission is currently developing a plan to restructure the social security system. It is inappropriate to change the current rules for private plan integration with social security until the restructuring of that system occurs. Certainly lowering the percentage rate for integration, shortly after the latest increase in social security tax rates, can be questioned even without an imminent restructuring of the social sceurity tax rate while lowering integration formulas clearly violates the principle providing a supplemental private retirement system.

UNIFORM NONDISCRIMINATION RULES FOR STATUTORY FRINGE BENEFITS

There are currently a variety of nondiscriminatory rules applicable to various fringe benefit plans. While uniform rules may be theoretically desirable the differences between fringe benefit plan structures and intent may preclude this. The proposed rules of H.R. 6410 are clearly inadequate. H.R. 6410 fails to define "equal benefits," a key term in applying any nondiscrininatory rules. For example, under an educational assistance program, does equality of benefits depend on the number of credits for which tuition expenses will be reimbursed or does it require that an equal dollar amount be available to each participant. The equal benefits test may also harm employers who attempt to contain health care costs by offering optional lower cost medical plans to their employees. H.R. 6410's treatment of nondiscriminatory rules are far too inadequate for serious consideration at this time.

ESTATE TAX EXCLUSION

Under present law benefits payable to beneficiaries of a deceased individual under a qualified plan or annuity or an individual retirement account generally are excluded from the gross estate for federal income tax purposes, provided the beneficiaries forego the special 10-year averaging and long-term capital gain income tax treatment applicable to certain lump sum distributions. H.R. 6410's imposition of a $500,000 limitation on the value of such benefits is arbitrary and without any sound theoretical foundation. The limitation will erode recently enacted increases in the unified credit included in the Economic Recovery Tax Act which merely approximate expected inflation. Limiting the estate tax exclusion adds to the disincentives for the creation and maintenance of qualified plans which run throughout H.R. 6410 which appear to be based more on revenue needs than sound tax and retirement policies.

STATEMENT ON BEHALF OF THE ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

AALU is a national association of approximately 1,100 members who specialize in one or more fields of advanced life underwriting. Collectively its members are responsible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving intricate factual situations and often dealing with complex business planning.

AALU is affiliated with the National Association of Life Underwriters (NALU), the largest life insurance industry field force organization in the United States. NALU is a federation of state and local associations whose membership totals approximately 140,000 life insurance agents. NALU fully endorses and supports the position presented by AALU.

AALU strongly recommends that the House Ways and Means Committee not approve any portion of H.R. 6410. If the Committee feels that legislation might be necessary to correct problems in the private pension system, then the Committee should direct its staff to study those particular problems and should ultimately schedule hearings of adequate length to permit a more in-depth examination of the issues. The hurried approach currently being followed is entirely inappropriate for major pension legislation in a hasty fashion without adequate study and based on a single day of hearings would be a gross injustice that would have unintended applications far beyond the range of those anticipated.

The bill in fact moves in a total opposite direction to that recommended by the only recent in-depth study made of the private pension system, the President's Commission on Pension Policy. That commission strongly urged the enactment of new incentives to foster the creation and expansion of pension plans. Such expansion would improve the retirement income of employees and reduce the burden on the social security system. The bill totally ignores these recommendations and, without any adequate justification, removes major incentives that have played an important role in expanding the coverage of the American workforce under the private pension system.

In addition to disrupting the payment of pension benefits the bill would decrease the valuable pool of capital made available by pension funds. This pool of capital, estimated to presently be in the range of $500 billion, may be the largest single source of private investment capital in the United States. At a time when this country is in desperate need of capital formation, H.R. 6410's enactment would be entirely inappropriate.

Pension plans are inherently long-term retirement arrangements that are not designed for frequent change. By enacting changes on a relatively frequent basis, Congress does serious psychological damage to the willingness of employers to maintain such plans. These changes dramatically increase the cost of maintaining pension programs and often lead employers to conclude that the frequency with which they must bear substantial costs maintaining plans outweighs the benefits provided by the plans. This conclusion can only lead to a major increase in plan terminations as well as a curtailment of the inception of new plans. This was the direct result of the enactment of ERISA in 1974 and can be expected again.

Administrative costs likely to be experienced on a national scale in complying with the provisions of H.R. 6410 in the immediate future have been estimated to be in the range of approximately $800 million. Based on the revenue estimates on H.R. 6410 as we understand them, this means that the bill would in fact produce a substantial revenue loss in fiscal 1983 that would not be recovered by the Treasury until approximately 1986. At a time when fiscal austerity is of utmost importance, such a result is inadvisable, to say the least.

Because the bill contains a variety of provisions touching on numerous aspects of pension and profit sharing plans, welfare benefit plans and other retirement benefits, we will describe with greater specificity the problems that can be expected from the enactment each specific section of the bill.

CONTRIBUTION AND BENEFIT LIMITS

Section 2 of the bill would drastically reduce the limits on contributions and benefits that can be made to qualified plans. These rules were established by Congress as part of the enactment of ERISA and represented a substantial cutback in the benefits available at that time. H.R. 6410 would further reduce these benefits from the levels that Congress established in 1974 after thorough consideration and debate.

The provisions of section 2 are incorrectly said to affect only a select few very highly compensated employees. Enactment of the proposed changes on the benefit and contribution limits for pension plans would in fact have a drastic negative effect on the pensions available to rank and file employees. This effect manifests itself primarily in two ways.

First, enactment of changes in the so-called "1.4 rule" would require many employers to substantially cut back existing plans or, more probably, to terminate one or more plans in their entirety. This is especially true for medium-sized and smaller employers, although to some extent it will be true for large employers as well. Any employer faced with the decision of having to terminate a plan will, in all probability, retain the plan that provides the greatest benefit for the management personnel. Therefore, the principal impact of adoption of the proposed modification to the 1.4 rule will be to cause employers to eliminate their retirement plan which is more likely to benefit rank and file employees in these companies.

The second adverse effect for rank and file employees comes about through what can be described as the "ratched effect." This principal is central to the design of pension and profit sharing programs in the private sector. It is often the case that the benefit formula in a plan is designed in a fashion that will provide a designated benefit to the management employees. The benefit provided to the rank and file employees is then the result of the formula developed for the management employees. Consequently, any reduction in the benefits that can be provided to the more highly compensated employees will probably result in a reduction of the plan benefits generally, thereby adversely affecting the rank and file employees. The highly compensated employees may, in fact, have their lost benefits made up through adoption of other types of nonqualified plans while the rank and file employees will have an absolute loss of benefits.

The resultant reductions in coverage will add pressure for make-up benefits from the social security system. As we all know, social security is not in any financial position to be saddled with additional benefit burdens. Numerous studies of the private pension system and its relationship to social security have observed that there is a strong relationship between the two and that cutbacks in the private pension system are likely to have substantial effects on the social security system. This was noted in a recent Brookings Institute study, "The Economics of Private Pensions."

Section 2 would also require the elimination of cost of living adjustments to the contribution and benefit limits for private pension plans. The contributions and benefit numbers, which are annually determined by the Internal Revenue Service, are the current equivalent of a $75,000 pension and a $25,000 contribution in 1974. Numerous governmental plans, such as the Congressional plan, Civil Service and military plans, contain cost of living and interest formulas. Substantially greater revenue—perhaps in the order of $15 billion—could be generated if Congress were to remove these cost of living formulas increases, rather than focus discriminatorily on the cost of living adjustments in the private pension system.

Elimination of the cost of living increases in the private pension system will have affects that apparently are not fully appreciated. For example, over time it is likely that all employees covered by pension plan will be adversely affected by these dollar limitations. To illustrate, under a relatively typical pension program, an employee age 25 would have his pension restricted by the repeal of the cost of living adjustments if he currently earns as little as $13,000. A response may be that Congress will doubtless adjust these dollar limitations upwards from time to time. Such ad hoc adjustments, however, run contrary to one of the main purposes of ERISA, i.e., to ensure current funding of benefits. Each time Congress raises the benefit levels, plans will experience unfunded past service liabilities that have to be amortized over future years. The net effect is to put plans in arrears in funding current benefits when one of the principal functions of ERISA was to try to bring plan benefits to a fully funded basis.

Another feature of section 2 is the elimination of the provision allowing retirement with full benefits at age 55. We understand that employees generally are retiring before age 65. As a consequence, requiring actuarial reductions before age 65 could have substantial impacts on a wide number of employees. Also, due to the ratchet effect described earlier, a requirement of actuarial reductions before age 65 may lead to general benefit reductions in plans. It should also be noted that governmental plans such as Civil Service have comparable provisions without requiring actuarial reduction.

As a final point, further restricts on the benefits that can be provided through pension programs, will bring with it competitive disadvantages for small companies (as compared to large corporations) in hiring and retaining talented individuals. Furthermore, domestic companies will be at a disadvantage when compared to foreign companies. Recent studies have shown that foreign companies generally provide more substantial benefits now than do domestic companies, so enactment of these limitations will further exacerbate the differential and will provide additional advantages to foreign competition.

RESTRICTIONS FOR LIFE AND HEALTH PLANS

Section 7 of the bill would create new restrictive provisions and nondiscrimination standards for many forms of statutory benefits, including well established benefits such as group life, health and disability insurance. There has not been any demonstration that there is a need to change the rules applicable to these forms of benefits. Congress enacted a provision, section 105(h) of the Internal Revenue Code, as part of the Revenue Act of 1978, that eliminated what was then perceived as the only significant problem in the provision of life insurance benefits under existing rules.

The existing rules on life, health and disability insurance have been responsible for the extension of this coverage to a broad segment of the workforce and have provided greater security against financial catastrophe. Any changes in this important coverage should only be enacted after very careful consideration of the effects that they will have. The proposals in H.R. 6410 would clearly undermine the continued expansion of this coverage and would produce major curtailments.

Just as in the case of pension plans, arrangements for life, health and disability benefits are often designed by employers with emphasis on the benefits available to top management. Consequently, reductions in those benefits, especially for life insurance, will have a ratchet effect similar to that that would occur in the pension field.

Requiring equal dollar coverage among employees for health insurance and disability insurance would have an even greater inhibiting effect on the expansion of health and disability coverage. In the case of disability, it is particularly inappropriate to require equal dollar benefits because differences in compensation level would not be taken into account. It is inherently unfair to believe that an employer should provide the same dollar of weekly disability pay to a high paid individual as to a low paid individual.

The current system of providing group life, health and disability insurance is subject to extensive state regulation underwriting requirements. This regulation adequately prevents the occurrence of any abuses and makes unnecessary the requirements proposed in H.R. 6410. Additionally, for group life plans with fewer than 10 employees there are already severely restrictive nondiscrimination standards.

SOCIAL SECURITY INTEGRATION

Section 4 of the bill would totally revise the social security integration rules for pensions. The existing rules have been developed by the Internal Revenue Service based on actuarial principles that provide a reasonable system under which employers receive credit for their contributions to the social security benefits of their employees. While these rules are highly complex, they are, at the same time, well understood by the technicians who must administer them. Consequently, changing them in the drastic fashion proposed in H.R. 6410 would create substantial confusion, with all the attendant complexity and cost that must be borne by employers.

These proposals are particularly ill-timed; they are being made at a time when the National Commission on Social Security Reform is currently studying social security and its relation to the private pension system. The Commission's report, which is due in December, may provide important insights into whether changes in the social security system are appropriate or not. The issue of social security modification has been considered by Congress twice in the last 10 years with a decision each time that no amendments are appropriate. Congress should not again take up this issue without having before it the Commission's report.

In addition to providing new general standards, the bill would provide a safe harbor rule that is entirely arbitrary in its application. Because it is tied to specific dollar levels of compensation, the safe harbor rule will become even more meaningless as inflation adjusts salary levels over time. It will add an additional layer of complexity that is not justified and will further complicate this already complex proposal.

RESTRICTIONS ON PARTNERSHIP AND SERVICE CORPORATIONS

Sections 5 and 6 of H.R. 6410 impose special new restrictive rules on partnerships and certain service corporations. These rules are inherently unfair and create insidious discriminations against individuals by reason of profession or form of organization. These distinctions are totally arbitrary and inconsistent with sound pension policy.

Further, these provisions can be expected to generate a substantial number of plan terminations with major benefit losses for rank and file employees. Again, we see the possibility of legislation having unintended effects on rank and file employees without full appreciation of the far-ranging nature of the proposals in H.R. 6410.

Classification by principal business function will in many cases affect large corporations that do not appear to be within the type of groups contemplated by the legislation. Consulting firms, for example, may have hundreds of employees and appear far beyond the scope of what apparently was intended by these provisions. These new distinctions will, in addition to being arbitrary and irrational, create complex distinctions in the law that will be difficult to administer. The Internal Revenue Service will have to decide what the principal function is of various organizations that may have multiple subsidiaries and different lines of business.

Also the proposed extension of the owner-employee Keogh rules to professional service corporation plans generally should be rejected. These rules were enacted to cover very limited situations and are inappropriate as a broad-ranging set of restrictions on incorporated businesses.

PROHIBITION AGAINST PLAN LOANS

Section 3 of the bill would prohibit plan loans to certain "key employees." Loans to employees from plans are currently permitted under nondiscrimination standards that require the loans to be reasonable and adequately secured. These participant loan provisions were devised by Congress as part of ERISA to ensure that plans must make loans available generally to participants on a reasonably equivalent basis.

To the extent any abuses exist currently in the use of plan loans, those abuses do not require the draconian solution proposed by this bill. The Internal Revenue Service has ample authority under the step transaction doctrine to attack sham loans in such situations where contributions are made and immediately borrowed in full by plan participants. In addition, the Department of Labor is currently developing regulations under the plan participant loan provisions of ERISA that can ensure that any loans made will, in fact, be genuine loans under the law.

The effect of the proposal in H.R. 6410 would, in many situations, lead plans to prohibit plan loans altogether if only because the administrative difficulties of determining who key employees are may be so burdensome that the maintenance of loan provisions is no longer expeditious. The definition of key employee, for example, includes any employee who is among the 15 percent highest paid. The 15 percent highest paid can include, for large corporations, thousands of employees and the grouping can change from year to year. Many of the employees that would be considered key employees will be relatively low paid individuals in many types of industries.

The availability of loans is an important incentive to the adoption of plans and does not constitute an abuse. Employees may be concerned about the ability to secure funds in the case of hardship or other difficulties. The ability to borrow is an important incentive that will encourage employee participation in many types of plans and will further encourage employers to establish plans for their employees.

Plan loans at reasonable interest rates with adequate security are merely another form of investment. The plan probably secures the same rate of return (or often a better rate of return) than it otherwise would have received on an investment. The plan assets have not been jeopardized and in fact, may have been enhanced by the making of the loan to an employee.

The bill also contains special, broader rules prohibiting loans generally in cash or deferred profit sharing plans under section 401(k) of the Internal Revenue Code. Congress adopted the cash or deferred plan provisions in 1978 as a means of encouraging personal savings towards retirement. One of the principal difficulties many younger and lower paid employees may have in accumulating their own funds for retirement is the concern that emergencies may arise before the funds are otherwise available. If the employee is forced to terminate his employment in order to receive funds, the anti-loan provisions will have worked an enormous disservice. Further, the ability to receive hardship distributions from these types of plans may be severely curtailed or in fact, entirely unavailable in many cash or deferred arrangements, especially since the Internal Revenue Service is developing very strict rules limiting the ability to make hardship distributions. Loans provide an entirely reasonable, reliable, safe and secure mechanism for covering these types of situations and no adequate justification has been presented for prohibiting loans.

We also understand that that anti-loan provision will only raise an insignificant amount of federal revenue by government estimates. Coupling this factor with the higher administrative costs associated with the anti-loan provision and the damaging psychological disincentive to the expansion of qualified plans, makes the adopting of these provisions unwise.

ESTATE TAX RESTRICTIONS

Section 8 of the bill would place a limit on the amount of pension benefits that can be transferred to dependents free of federal estate tax. We understand that this provision does not generate any significant amount of federal revenue. Its enactment would be a severe mistake. The estate tax exclusion is an important incentive for the establishment of qualified plans. Further, limitations on it would cause a curtailment in the establishment of qualified plans, with an attendant loss of plan coverage for employees generally.

Also, the use of a dollar limitation that is not subject to cost of living increases will mean that over time, an unexpectedly substantial number of employees will be affected.

CONCLUSION

AALU strongly recommends that the Committee not endorse any of the provisions in H.R. 6410.

STATEMENT OF BAKER INTERNATIONAL CORP.

Baker International Corporation opposes Section 3 of HR 6410, "Loans to Key Employees Treated as Distribution," in so far as it singles out for adverse tax treatment lower paid employees electing a cash or deferred arrangement within the meaning of Section 401(k) of the Internal Revenue Code. Baker International urges that employees participating in Section 401(k) plans be treated the same as participants in other qualified employer plans.

BAKER INTERNATIONAL AND ITS CASH DEFERRED PLAN

Baker International Corporation ("Baker") manufactures equipment and provides services for the petroleum and mining industries. Baker ranks 185 among the Fortune 500 and had revenues during 1981 of $2,140,016,000 and net income of $224,989,000. Baker has about 28,000 employees located in 40 states.

Baker adopted a cash or deferred thrift plan (the "Plan") effective September 1, 1981. A favorable determination letter on the Plan was issued by the Internal Revenue Service in February, 1982. The Plan was one of the very earliest cash or deferred programs implemented after enactment of Section 401(k). The Plan has been well received by Baker employees.

EFFECT OF CASH OR DEFERRED PLAN ANTI-WITHDRAWAL RULES

Section 401(k) virtually precludes employees from withdrawing contributions to a cash or deferred plan during continued employment. This restriction can be a major roadblock in obtaining participation in a cash or deferred plan by lower paid employees. Under such a plan, employees are given the right to elect to receive an amount in cash or to have it contributed by their employer to the plan. When such contributions are effectively put beyond reach until termination of employment, lower paid participants are much more reluctant to agree to save under the plan.

One of the best available approaches for overcoming this reluctance, while preserving plan contributions intact until retirement or other termination of employment, is a loan program. This assures lower paid employees that, should they ever need money, their plan savings will constitute an economic resource. This added security will convince many lower paid workers to participate when they otherwise would not.

BAKER'S LOAN PROGRAM

Baker's loan program was implemented for the sole purpose of encouraging lower paid employees to participate. Under the program, a Plan participant may borrow an amount not in excess of 75 percent of the borrower's vested interest. The minimum loan is $1,000. A participant may have only one loan outstanding at any time. Loans must be repaid through regular payroll deductions within three years. Loans bear interest at one point over the prime rate in effect when the loan is made.

The purpose of these restrictions is to preserve Plan accounts for employees until retirement or other termination of employment.

CONCLUSION

Baker acknowledges that legislation may be needed to prevent abusive loan practices in qualified plans but, if so, cash or deferred plans should be subject to the same restrictions as other plans. There is no sound reason lower paid employees participating in cash or deferred plans should be treated more harshly than lower paid participants in other plans.[1] In fact, there is a positive need for loans under a cash or deferred plan to be treated liberally in that loans are about the only way a cash or deferred plan can overcome lower paid employees' objections to saving money which cannot be tapped for many years. In Baker's experience, the rank-and-file employee participation in its cash or deferred plan was greatly increased by the availability of loans under its Plan. Increased rank-and-file participation is a laudable goal which should be encouraged by Congress since it will support this Country's objective of improving capital formation.

GROSSE POINTE WOODS, MICH.,
June 1, 1982.

JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I am writing to strongly urge the rejection and defeat of Bill H.R. 6410. Professional Corporations must be allowed to set aside adequate sums for their employees for retirement. This bill would reduce the maximum annual contribution permitted unjustly, and would adversely affect the contribution and benefit levels with respect to increasing with a cost of living index. I also believe that loans from pension and profit sharing plans should be permitted to key employees, but I oppose the placement of Professional Corporations under the more restrictive Keogh rules for purposes of participation investing.

I hope the House Ways and Means Committee will see the wisdom of defeating and rejecting Bill H.R. 6410 for I believe it will unfairly and unjustly penalize the thousands of employees of Professional Corporations.

Very truly yours,

THOMAS W. BAUMGARTEN, M.D.

H. W. BEAUDOIN & SONS, INC.,
Fort Myers, Fla., June 2, 1982.

JOHN J. SALMON,
Chief Counsel, House Office Building,
Washington, D.C.

DEAR MR. SALMON: I have read that on June 8, 1982 the House Ways and Means Committee will hold hearings on H.R. 6410, the "Pension Equity Tax Act of 1982". I am writing to let you know that I strongly oppose this Bill, and I urge you to do everything in your power to defeat it or any similar legislation.

As a small business person, my employees and I are largely dependent upon our abilities to save enough money out of our earnings to have a comfortable retirement pension. H.R. 6410 will substantially reduce my ability to save for my retirement and will increase the cost of providing these benefits to my employees. At a time when it is clear that social security can no longer be depended upon to provide adequate retirement income, this legislation is very disturbing to me.

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[1] Baker also wishes to state its objection to section 3 of H.R. 6410 to the extent it defines a "key employee" as "among the highest paid 15 percent of all employees of the employer." For large employers, this "key employee" group is much too big. For example, over 4,000 workers at Baker would be "key employees." For this reason, Baker strongly urges that the maximum number of individuals included under the 15 percent test be limited to a specific number, such as 25 persons.

If legislation is passed which reduces my retirement benefits, I will be forced to reduce the retirement benefits I provide to my employees, and I may have no choice but to terminate my Retirement Plan entirely.

I have already been subjected to considerable expense and inconvenience in attempting to comply with ERISA and other technical changes in the law, and any new regulations and rulings in H.R 6410 will further frustrate my retirement plans and those of my employees.

It seems ludicrous that in this economic climate, when Congress and others are struggling to find ways to stimulate the economy, that a bill could be introduced which will drastically reduce contributions to retirement plans and discourage small businesses from adopting retirement plans for their employees.

I urge you to do everything in your power to defeat H.R. 6410. Hoping to support you in the future.

Yours truly,

DAVID T. BEAUDOIN.

BELL, ENT & ASSOCIATES,
Indianapolis, Ind., June 15, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: This is a written statement for the printed record of the hearing on H.R. 6410, inappropriately titled "The Pension Equity Tax Act of 1982." Five copies of this statement are enclosed.

This statement is filed by: Richard N. Bell, C.P.A., J.D., Secretary, Bell, Ent & Associates, Professional Corporation, Certified Public Accountants, 7007 North Graham Road, P.O. Box 55225, Indianapolis, Ind., 46205; (317) 842-4466.

OUTLINE OF COMMENTS AND RECOMMENDATIONS

A. The bill will not raise income tax revenues because the taxpayers affected by the bill's contribution limits will invest in "tax shelters" to avoid additional tax.

B. Those who will suffer from H.R. 6410 include:

1. Common law employees.

a. Many plans will terminate because the bill reduces the benefits to officer-employees to the point at which plan benefits are outweighed by plan costs.

b. Even if a particular plan does not terminate, H.R. 6410 will reduce the retirement benefits of common law employees.

2. The Social Security System.

a. The termination or reduction of plan benefits will cause many common law employees to rely entirely on Social Security for retirement income.

b. The Social Security system could be devastated by demands that are being met currently by the private pension system.

3. The economy of the United States.

a. Pension contributions generally are invested in instruments which aid capital formation.

b. H.R. 6410 will encourage the flow of funds away from pension contributions and towards tax shelters which do not aid capital formation in as significant a manner.

C. The bill does not bring equity to the administration of retirement plans because:

1. Plan terminations or benefit reductions are in no way equitable to common law employees.

2. The bill discriminates against professional service corporations.

3. The prohibition of loans to key employees discriminates against all small businesses relative to large corporations.

4. The bill subverts the goal of parity between the retirement plans of incorporated and unincorporated professionals by bringing corporate plans down to the benefit levels of Keogh plans instead of the more equitable procedure of bringing Keogh plans up to the benefit levels of corporate plans.

D. We recommend the defeat of H.R. 6410.

TEXT OF COMMENTS AND RECOMMENDATIONS

Question. Will H.R. 6410 serve to raise tax revenues?

Answer. H.R. 6410 is intended to serve as a vehicle for raising tax revenues. Increased revenues purportedly would be accomplished by:

1. Decreasing the maximum annual benefit under a defined benefit plan from $136,425 to $90,000 and eliminating future cost of living adjustments.
2. Providing that a retirement benefit beginning before age 65 be the actuarial equivalent of a $90,000 annual benefit beginning at age 65.
3. Reducing the maximum annual contribution under a defined contribution plan from $45,475 to $30,000 and eliminating future cost of living adjustments.
4. Providing that where there exists both a defined benefit plan and a defined contribution plan, the current allowable ratio of 1.4 of the separate plan limits is reduced to 1.0.
5. Limiting to $500,000 the estate tax exclusion otherwise applicable to amounts payable under a qualified plan, tax sheltered annuity, or individual retirement account.

It is extremely clear that H.R. 6410 will not raise income tax revenues.—Reducing the maximum contribution limits will not lead to higher government revenues because the taxpayers affected by the limits will channel excess funds into "tax shelters" in order to avoid additional tax. For example, the Accelerated Cost Recovery System provided in the Economic Recovery Tax Act of 1981 allows for recovering the cost of investment real estate under a rapid 15 year method. Thus, real estate tax shelters, which are not subject to the "at risk" rules of Section 465, are a likely avenue for the taxpayer whose pension plan contributions would be limited under H.R. 6410. Of course, other tax shelters are also available, such as equipment leasing and oil and gas programs. In view of the availability of the various tax shelters the conclusion is inescapable that H.R. 6410 will not raise income tax revenues.

Question. Who will suffer from H.R. 6410 becoming law?

Answer. Given that wealthy taxpayers will not suffer from H.R. 6410 because of the availability of tax shelters, other taxpayers will bear the burden of this proposed legislation. Extreme hardship will fall on the lower paid, common law employees of American business. First, H.R. 6410 would be the impetus for many small businesses to either terminate their existing retirement plans or forego installation of a plan. Mass terminations will occur because the proposed legislation reduces benefits to the officer-employees to the point where the remaining benefits of a retirement plan will be outweighed by the costs. Currently, all plans require accounting costs and legal interpretation and drafting costs. Additionally, defined benefit plans require actuarial fees. To these already steep costs, the proposed legislation adds a significant number of disadvantages to officer-employees that will "tip the balance" in favor of either terminating existing plans or foregoing the installation of a plan.

Another factor pointing toward the conclusion that private pensions would be terminated in large numbers is the fact that retirement plan contributions are not perceived by America's small business owners to be as effective as higher present wages in procuring qualified personnel. The average individual would prefer a slightly higher weekly paycheck rather than pension contributions that will not be seen until some future date. This understandable bias against retireent plans will serve to reinforce the decline in benefits for officer-employees to cause plan terminations.

History suggests that many terminations would follow the enactment of H.R. 6410. We witnessed this result after ERISA was passed in 1974. While ERISA was undoubtedly good law, it was a complicated law. It became much easier for advisors to recommend the termination of retirement plans than to cope with the intricate provisions of ERISA. The same results will occur if H.R. 6410 is adopted.

Even if a plan termination does not occur as a result of H.R. 6410, the proposed legislation clearly will reduce the retirement benefits of many common law employees. For example, the proposed reduction of 34 percent in the maximum benefit under a defined benefit plan will cause the benefit of all employees to be reduced by 34 percent. Thus, common law employees will suffer even if a plan is not terminated.

Another significant "loser" under the bill would be the Social Security System. Since plans will be terminated or reduced, many common law employees will have to rely entirely on the Social Security System for retirement income. The already troubled Social Security System could be devastated by demands that are being met currently by the private pension system.

Finally, the economy of the United States in general will suffer from H.R. 6410. Pension contributions generally are invested in instruments which serve to increase the productive capacity of our nation (e.g. Treasury bills, money market funds). H.R. 6410 will encourage the flow of funds away from pension contributions and toward tax shelters. Without debating the social utility of tax shelter investments, it can be concluded reasonably that such investments do far less for capital formation than traditional retirement plan investment vehicles.

Question. Does H.R. 6410 provide equity in the administration of retirement plans?

Answer. The bill is intended to bring "equity" to retirement plans by:

1. Providing for the above mentioned deduction limitations.
2. Providing that loans from a corporate pension plan to a key employee would be treated as a distribution taxable as ordinary income to the employee.
3. Applying the Keogh rules regarding minimum participation, vesting, distribution limits, and loan prohibitions to personal service corporations.
4. Revising the Social Security integration rules so as to increase employer costs.
5. Eliminating all fringe benefits of key employees of professional service corporations.

First, we challenge the proponents of this bill to convince America's common law employees that it is in any way "equitable" to cause the termination of their retirement plan or a reduction in benefits. Second, the above listed provisions clearly discriminate against professional service corporations relative to other taxpayers. How can this situation be deemed equitable? Third, the prohibition of loans to key employees discriminates against all small businesses relative to large corporations. Finally, this bill subverts the goal of parity between incorporated and unincorporated taxpayers. The intent of the parity movement is to allow Keogh participants to have the same benefits as employees of incorporated taxpayers. This bill would achieve parity by bringing corporate plans down to the benefit levels of Keogh plans.

CONCLUSION

The goals of H.R. 6410 are to raise tax revenues, punish the wealth, and provide "equity" in pension administration. Based on our experience, we believe that, in fact, the bill will not raise revenues; will punish America's common law employees, as well as punishing the Social Security system and the economy in general; and will not provide for equity in retirement plans. For these reasons, we urge the defeat of H.R. 6410.

Sincerely,

RICHARD N. BELL.

STATEMENT OF BUCK CONSULTANTS, INC.

INTRODUCTION

Buck Consultants, Inc. opposes the Pension Equity Act of 1982 (H.R. 6410) or any other form of the bill with a similar thrust. Basically, we feel that the bill would damage the private benefit system in the United States, inhibit new plan formation, reduce employees' financial security and severely impede plan improvements.

Buck Consultants, Inc. is one of the largest employee benefit consulting firms in the United States. Buck provides comprehensive professional services to more than 2,000 pension and other benefit plans for clients located in all 50 states. The plans served by Buck cover more than 7 million active and retired employees and have assets totalling over $110 billion.

BASIC PRINCIPLES

Conclusion.—The impact of H.R. 6410 is of such sweeping magnitude that any such changes should only be made after careful deliberation by all concerned parties.

The Employee Retirement Income Security Act of 1974 was the result of approximately ten years of legislative process that began with the President's Cabinet Committee Report of 1965. Continual judicial and regulatory fine-tuning of the Act has gone on for nearly another decade since its enactment, and is still far from complete. In addition, Congress has amended the Act as recently as 1980. ERISA may need further legislative fine-tuning as well. However, as this background indicates, the entire pension area is enormously complex, and this bill involves sweeping changes. Accordingly, we would first like to emphasize the following three points with regard to H.R. 6410:

1. Major legislative changes in the benefit area should not be made without extensive consideration and opportunity for input from interested parties.
2. Major legislative changes in the benefit area should not be made under the pressures of current budgetary considerations.
3. Major legislative changes in the benefit area should be subject to extensive cost-benefit analysis.

Pension law has traditionally come under the joint jurisdictions of both tax law and labor law. Therefore, even though H.R. 6410 ostensibly deals only with tax law, the implications are so broad that consideration of the bill should not be limited to the Committee on Ways and Means. It should also be referred to the House Education and Labor Committee and more hearings over a reasonable time period should be held.

LIMITS ON BENEFITS AND CONTRIBUTIONS

Conclusion.—The proposed changes in the maximum benefits and annual additions for qualified plans and the proposed reduction in the current allowable ratio for combined defined benefit and defined contribution plans will have a negative impact on many employees, not just the higher paid.

Reduction in the current allowable ratio for combined defined benefit and defined contribution plans

This change will affect the low paid and medium paid, not just the high paid.

Examples

Consider the following two situations:

1. It is not unusual for a company to have a profit sharing plan where the employer's contribution is equal to 15 percent of each employee's compensation, or to offer one or more defined contribution plans with an aggregate annual addition in the neighborhood of 15 percent of compensation. Consequently, the defined contribution plan(s) could use up 0.6 of the 1.0 rule.

For defined benefit plans, the maximum benefit cannot exceed the lesser of the fixed dollar limit or 100 percent of an employee's three-year average compensation. With a combined plan limitation rule at 1.0, an employer with one or more defined contribution plans that generate a 15 percent annual addition could not have a defined benefit plan which provided a pension at age 65 in excess of 40 percent of an employee's three-year average compensation, regardless of the dollar limitation. It is likely that this would negatively affect employees who retire at age 65 with 30 or more years of service.

The effect would be felt by employees with less service who collect their retirement benefits before age 65. In fact, at age 55 under the bill's rules the defined benefit plan could not provide a benefit in excess of the lesser of $18,000 or 40 percent of an employee's three-year average compensation, or even less depending on the size of the actuarial reduction.

In the situation involving 15 percent annual addition defined contribution plans, up to 60 percent of the employee's retirement income would be subject to investment risk. This is due to the fact that employees bear the investment risk under defined contribution plans. Employers bear the risk under defined benefit plans.

2. One of Buck's major clients has estimated that these proposals would have a major impact on its salaried employees. The company has a defined benefit plan with a normal retirement age of 65, plus a savings plan. The company, which has over 50,000 salaried employees, estimates that 1,400 employees will hit the limits in 1984, 4,000 in 1990 and 11,000 in 1993. This would, in effect, disenfranchise a large group of employees unless the company offers supplemental nonqualified pension plan benefits to these individuals.

Self-help

An important reason for the 1.4 rule is that it encourages employee contributions to defined contribution plans. Recent changes in the Internal Revenue Code and regulations have indicated that Congress wants to encourage employees to apply the "self-help" concept by saving for their retirement.

However, reducing the 1.4 factor to 1.0 could deal a severe blow to the Congressional policy aimed at strengthening this important leg of the three-legged retirement stool.

Employee contributions, above certain limits, to retirement plans in many cases would reduce employer-provided benefits—on a dollar-for-dollar basis—under a 1.0 system. Thus, employee contributions would become very unattractive to employees.

Most defined contribution plans contain features that are more favorable to participants than those under defined benefit plans, such as early vesting and portability of benefits. They are currently among the best understood and most appreciated retirement programs, and yet the 1.0 limit would hurt these plans. H.R. 6410 would make these programs less effective.

Security

One of the most important aspects of the current defined benefit pension system in the United States is the funding rules which promote assurance to employees that their benefits will be available when they retire. As noted above, many employees, not just the high paid, will find their benefits reduced as a result of these proposals. If companies provide the extra benefit through a nonqualified excess pension plan, these benefits will no longer be protected by the funding rules.

Valuation costs

Reducing the factor from 1.4 to 1.0 will require more extensive testing of the allowable maximums in defined benefit pension plan valuations, where the employer has one or more defined contribution plans in addition to the defined benefit plan. This is one of the many areas in this bill where employers will have increased administrative costs.

Inhibiting plan formation and continuation

Reducing the maximums is likely to inhibit the formation of new plans and the improvement or continuation of ongoing plans. If benefits are smaller for owners and management employees—particularly in small firms—there will be less incentive for them to set up plans or to cover their employees.

SOCIAL SECURITY INTEGRATION

Conclusion. We are opposed to the proposed changes in integration in their current form since the consequence is to increase substantially the allowable offset for Social Security benefits for employees who terminate at lower ages while simultaneously reducing the allowable integration for those terminating at the typical retirement ages.

The changes proposed in the Social Security integration rules are an example of how the bill is poorly thought out. The following table compares the current level of integration to that permitted under the bill.

COMPARISON OF INTEGRATION AT AGE 65 UNDER CURRENT RULES WITH RULES UNDER BILL ASSUMING THEY APPLIED TO CURRENT PARTICIPANTS

[1981 income equals $15,000]

Age at termination	Service at termination	Social security offset	
		Current rules	Bill's rules
64	10	$5,055	$704
54	10	2,457	1,147
44	10	1,687	1,869
34	10	1,293	3,044
64	20	5,295	1,173
54	20	3,329	1,910
44	20	2,551	3,111

Consistent with the bill's apparent intent, the bill's rules would reduce the level of allowable Social Security offset drastically for employees who terminate employment at what is typically called retirement age. However, for employees terminating before ages 45 to 50, the bill's rules would increase substantially the allowable integration. The impact of the latter could have the effect under defined benefit plans of reducing or eliminating vested benefits for the younger members of the workforce.

The changes in the integration rules represent a reversal of public policy which has been in place for nearly 15 years. If our table had included an employee age 64 with 30 years of service, it would have shown that the allowable offset would be less than 25 percent of the employee's initial Social Security benefit. We can find no rational reasons for limiting the integration for full career employees to this extent.

Sound public policy in the area of defined benefit plans should focus on the coordination of benefits provided by Social Security and private pension plans, not on contributions or who pays what taxes. Retirees live on benefits paid by private plans and Social Security, not on the contributions or taxes paid into those programs. The taxes paid today for OASDI were designed only to match revenues attributable to current workers with the payments to current beneficiaries. The taxes paid by and for current workers bear no relationship to the cost of benefits which they will ultimately receive. It is clear from the above table that the solution offered in the bill in focusing on taxes paid produces illogical results in terms of the benefits which would be provided by private pension plans.

The rules in the bill for defined benefit plans would lead to increased administrative cost in keeping track of the OASDI tax paid for each employee. There would be the need to have different summary plan descriptions for the employees covered by different benefit rules.

By cutting back so drastically on the integration for older employees and applying the new rules only to new plan participants after December 31, 1983, the bill would create a substantial economic disincentive to hiring older employees. This is clearly contrary to the policies which Congress has been trying to encourage.

Note also that employers will face high costs in making these changes. It also is not clear what the revenue impact of these changes will be. A complex model is needed to make reasonable estimates.

LOANS FROM QUALIFIED PLANS

Conclusion.—The restriction and/or elimination (in the case of section 401(k) plans) of loans to participants from qualified plans will likely have the unintended effect of limiting accessibility by the lower and medium paid to monies in times of unanticipated need.

Section 401(k) limitations

From an equity standpoint, the younger and lower paid employees—not the highly paid—would suffer most from the effective elimination of loans under section 401(k) plans. The younger and lower paid would be discouraged from participating in these plans if the bill's loan provision were enacted—assuming their employers would even adopt them with this punitive feature. Younger and lower paid employees often find temporary loans from savings and profit sharing plans most important in financing home purchases, children's education, and medical and other unanticipated expenses.

Section 401(a) limitations

The bill's definition of "key employee" is too broad with respect to loans from any qualified plan. The arbitrary definition of a "key employee" as anyone within the highest paid 15 percent of all employees would affect many employees of large employers. In short, many "smaller fish" would be netted along with the "big fish."

From a public policy standpoint, the bill's loan provision is puzzling indeed. It represents a complete reversal of current public policy in midstream. A cornerstone of that policy is to encourage capital formation, i.e., long-term saving. This was among the primary purposes of the Revenue Act of 1978 and was reemphasized in the Economic Recovery Tax Act of 1981. Presumably, it was also the rationale for the revitalization of section 401(k) cash or deferred and salary reduction arrangements, first in the Revenue Act of 1978 and then in recent Treasury regulations. Accordingly, many of these plans are already in place or about to become effective, and their features have been communicated to participants.

The sudden policy reversal that this bill would effectuate leads us to wonder exactly what signals Congress is trying to send to the American business community? Can it expect a reversal of public policy every other year, or can it reasonably rely on the direction established by Washington for more than a year at a time?

It has long been recognized that loans to employees are appropriate plan investments. Accordingly, bona fide, arm's-length, nondiscriminatory loans should not be restricted. The advantages of loans by plans are well-known:

(1) They are more effective and less costly to employees than taxable "hardship" distributions.

(2) They are often simpler and more convenient to obtain, and loan repayments can be simplified through payroll deductions.

(3) Perhaps most importantly, plan loans must be repaid and therefore will add to retirement savings and will be available at retirement, whereas a "hardship" distribution in lieu of a loan will not. Thus, restricting these loans runs counter to the very purpose for which these plans are established—to provide for the employee's retirement. Moreover, plan loans are available as a resource to the employee irrespective of his or her credit line.

Again, it should be noted that these features work to the advantage of younger and lower paid employees. It has been our experience that loan provisions are used, in times of financial need, by employees at all income levels.

In addition, the Internal Revenue Service and Department of Labor have adequate authority to deal with abusive or sham loans.

PERSONAL SERVICE CORPORATIONS

Conclusion.—The legal form and type of business should not be determinative of qualified plan consequences. Rather, whether a given plan is discriminatory in operation should control.

We believe that the proposed new rules for personal service corporations should not be defined in terms of the type of business involved. In particular, we believe that these rules, if they apply at all, should not apply if the firm in question has no owner-employees and should not apply if a firm has more than a certain number of employees who are not owners at all.

Buck is a corporation which provides employee benefit consulting and administrative services, including actuarial services. We have over 650 employees, of whom over 10 percent are stockholders, but none of these shareholders has more than 5 percent of the stock. We should not be treated differently from a manufacturing firm with the same number of employees, most of whose stock is owned by a lower percentage of its employees. A Buck employee who owns stock should not be treated differently from a comparable employee in an insurance company or a manufacturing company who owns the same proportionate number of shares of stock.

It should be kept in mind that the new rules will increase costs for pension plans for small employers and might be a disincentive for owners of small professional service corporations to cover their employees under a pension plan.

Furthermore, we do not find any support for the rationale that the legal form of the employer—partnership or corporation—should have any bearing on the retirement benefits which can be provided to partners or employee shareholders. The type of commercial or non-commercial activity of the organization also should have no bearing on the retirement benefits which can be provided.

FRINGE BENEFIT PROGRAMS

Conclusion.—It is our judgment that the increased administrative costs would far outweigh any possible benefit from these nondiscrimination rules.

The proposed nondiscrimination rules for statutory fringe benefit plans (including group insurance plans) would add a significant compliance cost burden for employers. This would create yet another bureaucratic layer since these plans would most likely have to seek qualification and follow various IRS regulations, rulings, etc. We would question whether discrimination in group insurance plans is serious enough to justify these nondiscrimination rules.

SUMMARY

As noted above, there are serious problems with H.R. 6410. It appears to have been hastily constructed without adequate consideration of the issues involved. The bill—

Would hurt the middle and even low paid, although its intent is only to reduce benefits for the high paid;

Would discourage individuals from saving for retirement and thus discourage self-help;

Would diminish benefit security offered by funding rules;

Would institute Social Security integration rules that lead to illogical results;

Would increase employer administrative burdens;

Could inhibit pension plan formation and lead to termination of existing plans—particularly for small business;

Would define improperly personal service corporations and thus include firms like Buck which should not be considered personal service corporations.

The bill deals with major benefit issues which need more careful consideration and should not be dealt with in a "crisis" budget deficit atmosphere. Furthermore, it is not at all clear that the bill would lead to any material increase of Treasury revenues. A thorough cost-benefit analysis is needed.

The bill is not appropriate at this time. Employers continue to struggle with great burdens under ERISA. H.R. 6410 will increase these burdens.

BUCYRUS-ERIE CO.,
South Milwaukee, Wis., June 21, 1982.

Ms. HARRIETT LAWLER,
House Ways and Means Committee, Washington, D.C.

DEAR Ms. LAWLER: It has just come to our attention that a bill has been introduced in the U.S. House of Representatives, HR6410, that would cause substantial limitations on a broad range of employee benefits.

Although we will be unable to testify at a public hearing, we wish to go on record requesting that our Federal government not further intrude in the benefit planning area, particularly with hastily created plans that search for additional government revenues.

While the stated intent of this bill appears to be the allocation of government tax subsidies more "equitably" among employees, a politically expedient position, the unintended results require substantially more study and discussion.

Cordially,

C. R. REVIE,
Director, Human Resources.

BURROUGHS CORP.,
OFFICE OF THE TREASURER,
Detroit, Mich., June 18, 1982.

Representative DAN ROSTENKOWSKI,
Chairman, House Committee on Ways and Means,
Washington, D.C.

DEAR REPRESENTATIVE ROSTENKOWSKI: The purpose of this letter is to enter the following comments into the public record regarding proposed House Bill H.R. 6410.

H.R. 6410 was introduced in the Congress on May 19, 1982, a public hearing was to have been held before the House Ways and Means on June 8, 1982 and written comments will be accepted through June 18, 1982.

This legislation, literally, will effect all workers and taxpayers and has implications on capital formation. We are concerned that this proposed legislation is being rushed to a conclusion and enactment before complete studies of the bill's implications have been made. The complexity of the issues is evidenced in the Congressional history leading to enactment of the Employee Retirement Income Security Act of 1974 (ERISA). Congress passed the pension reform law, ERISA, after three years of intensive investigation, study and hearings. There is no need to rush, and the facts suggest prudence is essential.

First, at a time when people are looking to the private system to provide retirement benefits it seems the restrictive nature of H.R. 6410 on the private system is ill-timed and inappropriate.

Financial security and income in retirement is generally thought of as being provided through three sources; social security, pension plans and individual savings. Social security has been experiencing severe difficulties because of its indexing methodology, demographics, the economic environment, etc. Severe cutbacks in social security benefits are likely. Personal savings have also been strained because of the impact of inflation on ability to save. Now, the Pension Equity Tax Act will significantly limit the private pension system to deliver adequate retirement income.

Second, the way in which social security and private pension benefits are combined to provide adequate retirement income is significantly restricted by the bill. Until adequate reforms are made to the social security system—financing, benefits and administration—it seems premature to enact legislation which could limit or give excuse to delay needed changes in the social security system, or which may become ineffective by future changes in the social security benefits.

Third, contrary to its stated objective, the bill will affect more employees than just the "key employees" or highly paid. In reality, because of the elimination of future cost-of-living increases in the contributions and benefit limitations under qualified plans, continuation of inflation, at rates anywhere near recent years, would ultimately result in most plan participants having the limitations of the H.R. 6410 bill apply.

Fourth, the H.R. 6410 bill may restrict creation of and funding private pension plans and, thus, may effect capital formation. One of the largest sources of investment capital has been the private pension funds. Given the President's and the Congress's concern to promote capital formation, the major potential impact of this bill deserves careful study.

This comprehensive bill should not be rushed to enactment. Particularly at this time. The U.S. economy is in a recession and actions that discourage desperately needed capital investments would be very unwise.

We strongly oppose passage of this bill. We urge you to make the careful and thorough studies that such legislation deserves.

Sincerely,

James J. Biundo,
Assistant Treasurer,
Trust Investments, Pensions and Risk Management.

Statement of the Chamber of Commerce of the United States, by Peter M. Kelly

The Chamber of Commerce of the United States is the largest federation of business and professional organizations in the world, and is the principal spokesman for the American business community. The U.S. chamber represents more than 240,000 members, of which more than 235,000 are business firms, more than 2,800 are state and local chambers of commerce, and more than 1,300 are trade and professional associations.

More than 85 percent of the Chamber's members are small business firms having fewer than 100 employees, yet virtually all of the nation's largest industrial and business concerns are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at-large.

Besides representing a cross-section of the American business community interms of number of employees, the U.S. Chamber also represents a wide management spectrum by type of business and location. Major classifications of American businesses—manufacturing, retailing, services, construction, wholesaling, and finance—all have nore than 15,000 businesses represented as members of the U.S. Chamber. Yet no one group represents as much as 23 percent of the total Chamber membership. Further, the Chamber has substantial membership in all 50 states.

Good morning, I am Peter Kelly of Chicago, Illinois, partner in charge of the Employee Benefits Department of the law firm of Kirkland & Ellis and a member of the Employee Benefits Committee of the Chamber of the United States. Accompanying me is Michael Romig, Director of the Human Resources and Employee Benefits Division.

We appear before this Committee on behalf of the Chamber's more than 240,000 business, trade association and chamber of commerce members, all of whom would be directly and adversely affected by the Pension Equity Tax Act of 1982 (H.R. 6410). We therefore oppose the bill.

SUMMARY

Enactment of the Pension Equity Tax Act of 1982 will have far reaching implications for the retirement security of nearly every working American. The drastic and sweeping reversals in the tax incentives for private pensions and other employer-sponsored benefit plans could result in severe—possibly irreparable—damage to this important segment of America's retirement security. As such, the Chamber of Commerce of the Untied States is opposed to H.R. 6410. We believe that such sweeping changes should be studied at length by all those who would be affected. Its implications should be fully understood and, above all, it should square with overall economic and retirement policy objectives. Such a drastic change should not be the product of a hasty one day hearing searching for additional revenues to unlock a budgetary stalemate.

A. Success of current tax incentives

If enacte, H.R. 6410 would represent a fundamental shift in national retirement policy away from the encouragement of employer-sponsored pension and employee benefit arrangements to supplement Social Security and personal savings to one of actual discouragement. Such a shift would complicate an already tough task for the

National Commission on Social Security Reform which must find ways to limit the future costs of Social Security.

Since 1942 a coordinated system of tax incentives encouraged employers to establish qualified retirement plans which satisfy non-discrimination standards. As a result, the history of private retirement plans is one of remarkable growth. Because of tax incentives that defer taxes until retirement, private pension plans face a strong and promising future. They cover a steadily increasing number of workers; over 40,000 net new private pension plans have been created each year since 1971. By the turn of the century, over two-thirds of newly retired workers are likely to be receiving pension benefits. Currently, private pensions pay benefits to over 50 percent of recently retired persons, 35 percent of those over 65, and provide coverage to over 74 percent of prime-age fulltime nonagricultural workers.

Private pension plans affect the capital markets with nearly $600 billion in assets. They are the single largest source of new investment capital each year, having added over $20 billion in 1981, and have grown since 1975 at the annual rate of 9.2 percent after adjusting for inflation. The private retirement system has played a crucial role in sustaining our economy through a decade or more of low savings rates and considerable economic stagnation.

The performance of the private retirement system over the past 30 to 40 years should make all connected with that system proud. In an era when tax incentives are criticized by some as inefficient federal expenditures, the tax incentives for qualified plans have performed their intended mission so well that legislative proposals to expand these incentives have often been successfully enacted (e.g. Individual Retirement Accounts, 1974 and 1981; Keough contributions, 1962, 1974, 1981). The widespread public perception of the effectiveness of the private system certainly compares favorably with that of the Social Security system. Public opinion polls report that the American people have considerably more confidence in the private system than in Social Security. Serious people must question the justification for H.R. 6410 which threatens not only the private pension success of the present but the promise of its future as well.

B. General objections to H.R. 6410

Because of the beneficial impact of the existing tax incentives and for the other reasons described more fully below, I wish to speak this morning in opposition to most of the provisions of H.R. 6410. I have made reference to the specific areas of disagreement with H.R. 6410 in the technical analysis which has been entered in the record for this hearing and is appended to our statement. In addition to these technical objections to specific provisions, I would offer for consideration the following more general objections:

(1) H.R. 6410 is not based on any study of its likely impact on the private retirement system;

(2) H.R. 6410 has been proposed without consideration of its disproportionate impact on future generations of retirees in an economy in which the current disinflation may well be a short term experience;

(3) H.R. 6410 modifies the tax provisions of ERISA in a way which will increase plan administrative burdens and reduce employer incentives. There is no attempt to coordinate the activities of this committee with the simultaneous efforts of the President's Regulatory Reform Task Force or the House and Senate Labor Committees to streamline ERISA and reduce plan adminstrative burdens. It would leave untouched the complex and confusing tax qualification provisions which are as much a source of the administrative burdens with which the Labor Committees are concerned as are the labor provisions of ERISA. Finally, it complicates an already difficult task for the National Commission on Social Security Reform which must find ways to contain the future cost of Social Security.

(4) H.R. 6410 has come before this committee less than three weeks after its introduction. This presents a risk that a proposal having profound long term impact on the private retirement system and on the economy will be acted upon without an adequte development of the issues.

(5) H.R. 6410 is being hastily considered by the Committee without adequate time for full development of public comments because of its role in formulating a federal budget for the fiscal year beginning October 1, 1982. However, an examination of the proposed effective dates of H.R. 6410 indicates that it will have little effect on federal revenues during that fiscal year.

(6) H.R. 6410 discriminates against the service segments of the economy. This discriminatory impact is not justified by activities unique to service industries and fails to recognize the interdependence of the various sector of the economy.

C. Discussion of general objections to H.R. 6410

1. *Failure to Study Impact on Plan Formation and on Savings and Investment.* In light of the private pension system's history of solid achievement, it is perplexing that a basic change in the tax rules which provide the incentive responsible for private plan growth would advance so rapidly without study of the potential impact of such changes on new plan formation. Such a study should incorporate pessimistic assumptions as well as more traditional optimistic and intermediate assumptions. This would provide Committee members with a more reasonable assessment of the range of possible results from this legislation. Certainly, post-ERISA plan formation statistics should provide some evidence that the tax incentives may have already been considerably eroded by ERISA. Further erosion of the tax incentives could have disastrous results for future generations of retirees.

2. *Failure to Consider Impact on Future Generations and Long Term Inflationary Trends.* H.R. 6410 raises serious issues for future generations, particularly the post World War II generation which has already been recognized as having experienced a dramatic reduction of expectations from the uncontrolled optimism of the 1950's and early 1960's. This generation has experienced scarce and overly expensive housing as well as diminished opportunities and salary compression in the workplace. This is the generation which must pay the price of past underfunding of Social Security and of federal, state and local government retirement commitments. Must this generation now accept the rollback of private retirement plan limits to 1978 levels without any hope of future upward adjustments?

What I am speaking of is a pure and simple question of generational fairness which must be considered prior to enactment of such limitations. The Committee must address this question of equity and fairness among all generations of Americans—the oldest, the youngest, and even the unborn generations that will follow us.

3. *Failure to Coordinate the Proposal with ERISA Relief Legislation or with a Simplification of Basic Qualification Rules.* For several years it has widely been recognized that ERISA amendments are necessary to relieve excessive burdens imposed by ERISA on large and small employers. Hearings have already been held in both the Senate and the House Labor Committees regarding these ERISA relief proposals (H.R. 4330; S. 1541). With the likelihood of a major legislative effort to amend ERISA this year or next, it would appear most efficient to address the proposals contained in H.R. 6410 as part of this broader legislative package. At that time, attention should also be given to the broader issue of simplification of the qualification rules to reflect the evolution of the private retirement system since the 1940's.

4. *Failure to Provide Sufficient Time for the Development of Issues Related to the Proposed Changes.* Less than three weeks have passed since H.R. 6410 was introduced. Only a handful of professionals practicing in the employee benefits field have had an opportunity to review the description of the legislation. An even smaller number of well informed professionals have had an opportunity to review the bill. Few of the business leaders among your own constituents who will be concerned with and affected by this legislation are even aware it has been made.

Thus, there has been no opportunity for the gathering of a full range of views regarding the overall policy implications of this proposal and technical defects in the bill itself. This inadequate development of the issues regarding a proposal having such long term impact on private retirement plans and the economy as a whole creates a risky situation that is both imprudent and unnecessary.

5. *Inapplicability of the Proposal to the Budgetary Period Used to Justify Expedited Hearings.* Consideration of the bill has been expedited as part of the budgetary review for the fiscal year beginning October 1, 1982. However, any realistic assessment of the revenue of H.R. 6410 in light of its effective dates and the practical impossibility of accelerating those effective dates will show clearly that it has little impact on the fiscal year 1982. In fact, it will show that H.R. 6410's first significant impact would be on the fiscal year beginning October 1, 1984. The failure to proceed in a more deliberative fashion and permit more cautious development of the issues related to the impact of the bill is perplexing since the reason given for its urgent consideration of this legislation simply does not apply.

6. *Discrimination Against Service Industries.* H.R. 6410 indentifies a new classification of corporations which will be subjected to the additional administrative costs of complex benefit payment and other restrictions. These companies would be denied the 4-40 safe harbor granted by past Congressional action (HJR 644, P.L. 96-536) and would be forced to pay the costs of faster vesting. In so doing, the bill focuses on a growing segment of the economy composed of service industries. Although not all service companies will be affected, the language is so broad as to encompass widely disparate types of companies, large and small.

It is certainly an advancement toward the objective of demystifying the federal rules regarding retirement plans by introducing parity between Keough plans and corporate plans. However, acceptance of parity raises the question of whether we also need the other Keogh restrictions to cover this new category of personal services corporations.

Our economy is growing increasingly interdependent. Large and small corporations depend on one another through supply and customer relationships. Large financial and other institutions increasingly provide a significant portion of their services to relatively small companies and also to retirement plans maintained by those companies. It is the interest of all business to stand together in resisting these proposals.

D. Summary

A careful review of the technical objections to H.R. 6410 set forth in the attachment will reveal that the objective of covering a broader group of employees may be only partially achieved and in many cases will be frustrated. The bill appears to be designed primarily as a punitive step against employees who are highly compensated by today's standards but for whom the proposed limitations may be inadequate by tomorrow's standards. And while it may be successful in this quest, it does so by significantly reducing pension benefits for a substantial number of rank and file employees as well.

While we do strongly agree with the objective of insuring that the budgetary process produces an equality of burden, it is crucial that this equality not be achieved at the expense of the long term health of the nation's retirement system. Other methods for equalizing burdens should be devised which are consistent with the long term national policy of encouraging retirement savings.

A more principled approach would involve a disciplined study of the long term impact of this proposal. Other methods of equalizing budget burdens should be explored so that we, as a nation, will avoid short term retribution against our fellow citizens at the cost of long term harm to our society.

TECHNICAL ANALYSIS OF PENSION EQUITY TAX ACT OF 1982 (H.R. 6410), PREPARED ON BEHALF OF CHAMBER OF COMMERCE OF THE UNITED STATES, BY PETER M. KELLY

A. INTRODUCTION

On May 19, 1982, H.R. 6410, the Pension Equity Tax Act of 1982, was introduced by Congressman Charles Rangel of New York. In describing the legislation (128 Cong. Rec. H2353, May 19, 1982) Congressman Rangel recited the following objectives of H.R. 6410:

1. Broader coverage.—The bill is intended to increase tax incentives to bring about comprehensive inclusion of the broadest possible class of employees in pension and fringe benefit plans.

2. Limit contributions and benefits.—The bill seeks to limit pension accumulations which are referred to as being "excessively high" under existing law. The bill broadens the group of individuals asked to accept benefit reductions through government spending cuts by limiting tax deductions to $30,000 per year per individual under defined contribution plans and to the amount which will provide defined benefit plan benefits of $90,000 per year.

Congressman Rangel views these limitations as rational and defensible limits for government involvement in employee benefit plans. He stated that the bill is not intended to curtail or limit retirement savings, but rather to limit tax deductions for such retirement contributions.

Although there has not been adequate time to review the technical provisions of H.R. 6410 it is appropriate to note that H.R. 6410 is unlikely to achieve these objectives. Indeed, H.R. 6410 is more likely to:

(1) Significantly reduce the protections offered by private pensions to all segments of our workforce;

(2) Increase public dependence on an already weakened Social Security system;

(3) Erode our nation's largest source of investment capital; and

(4) Force major and unnecessary changes upon private pension plans.

B. CONTRIBUTION AND BENEFIT LIMITATIONS

H.R. 6410 would impose new maximum annual contribution and benefit limitations under qualified plans as follows:

1. Maximum annual contribution for each defined contribution plan participant would be rolled-back and frozen at $30,000, with no future cost of living increases.
2. Maximum annual benefit for each defined benefit plan participant would be rolled-back and frozen at $90,000, with no future cost of living increases, and would be actuarially reduced for participants retiring before age 65 (under current law there is no reduction for benefits commencing at or after age 55).

These limitations are considerably less than existing limitations and in fact represent a roll-back of limitations to the level that existed during 1978. During that year the limit on defined contribution plans was $30,050 and the limit for defined benefit plans was $90,150. As a result of cost of living adjustments the limit in effect for 1982 is $45,475 for defined contribution plans and $136,425 with respect to defined benefit plans.

These new limitations would apply equally to corporate and self-employed H.R.-10 plans. This would establish a principle of parity which has been sought for some time by representatives of small businesses. However, the percentage of compensation limit under H.R.-10 plans would remain at 15 percent compared to 25 percent limit for individuals in corporate plans.

The 1.4 combination limit where both a defined benefit plan and a defined contribution plan are maintained would be reduced to 1.0. (This will force a reduction in the contributions or benefits permitted under current law.) Proposals to impose a 1.0 combined plan limit were previously considered as part of the ERISA deliberations by the Conference Committee and rejected at the insistence of representatives of the Ways and Means Committee serving on that Conference Committee.

In his summary Congressman Rangel refers to these limitations as deduction limits and indicates that he does not intend to prevent further contributions or accruals under such plans if there is no additional tax incentive. However, a review of the legislative proposal itself reveals that the limitations would continue to serve as qualification requirements and not as deduction limitations. As a result, H.R. 6410 would achieve a greater limitation than Congressman Rangel indicates he intends since it would prevent any qualified plan from providing additional benefits even though no deduction is claimed for the excess over the new limitations. If the provision is intended to operate solely as a deduction limitation, changes would be required not only in Section 415 of the Code but in Section 404 of the Code to reflect this intension.

Parity between HR-10 plans benefiting small business and corporate plans should be supported. It will reduce complexity and discourage inappropriate incorporation of many small businesses. However, any attempt to roll back the defined contribution and defined benefit limitations and remove the opportunity for cost of living adjustments would be ill-advised. Nothing tampers more directly with the incentive system upon which the private retirement system is founded. In fact, recent growth in the rate of plan formations may be due in part to the cost of living adjustments to the Code Section 415 limitations. The COLA provision certainly has reintroduced an incentive element in the decision to establish a retirement program.

A careful analysis of the proposed new limitations would indicate that virtually all types of businesses, large and small will be affected by these changes. While the initial effect on unincorporated small businesses will be favorable, the limitations are so low as to suggest a likelihood that in a few years those limitations will be inadequate for all types of businesses. In any event, the limitations are wholly inadequate and unrealistic for most large companies. This is particularly true of employers seeking to introduce profit-oriented incentive programs designed to encourage employees to become more productive, to adopt a long term perspective with respect to its business and to contribute to the nation's economic recovery.

It is ironic that a bill designed to restrict benefits for highly compensated employees would also limit benefits for many employees who are not highly paid. Many rank and file employees will accumulate lower benefit amounts because of plan formation, continuation, and improvement decisions influenced by the proposed contribution and benefits limitation. In addition to this indirect impact on lower paid employees, the recommended 1.0 combined plan limitation will directly affect many rank and file employees. For example, any employee who is covered by a 25 percent of pay money purchase pension plan and also is covered by a defined benefit plan would suffer a contribution or benefit reduction as a result of a change from the present 1.4 rule to the proposed 1.0 rule.

C. PLAN LOANS

H.R. 6410 would impose limitations on loans to officers, five percent owners and the top 15 percent highest paid employees. Such a change would correspond with limitations applicable to HR-10 plans and would reinforce the notion that retirement plans are designed to provide security during retirement years rather than to meet the needs of current consumption.

While this change would appear to be consistent with a long term emphasis on retirement savings, at least two aspects of the change ought to be studied prior to its adoption. The imposition of a 15 percent standard for determining highly paid individuals could create tremendous hardship, particularly for larger employers. A plan administrator or trustee attempting to comply with the loan restrictions would be excessively burdened if a plan covers a large number of plan participants. It may be extremely difficult to determine which employees are among the highest paid 15 percent where an employer has 10,000 or more employees in multiple locations and on multiple payrolls. For example, an employer employing 10,000 employees would have to identify 1,500 employees to assure compliance with these restrictions and a company employing 50,000 employees would have to identify 7,500 employees in order to comply with these restrictions. A more workable solution could involve a lesser percentage or a maximum number of highly paid employees who could fall within the prohibited group.

In addition, the problem of employee turnover should be considered. Many employers who utilize loan provisions do so because they have had unfortunate experiences where employees sought other employment simply as a method for obtaining part or all of their retirement plan benefits for current consumption purposes. While this is a significant reason for considering a loan provision it may be that the Committee could develop alternatives which would respond to this concern.

This loan proposal is likely to have its greatest impact on small companies where loans have been utilized more frequently than has been the case in large corporations.

D. EXTENSION OF OWNER-EMPLOYEE RULES TO ALL H.R. 10 PLANS AND TO ALL PERSONAL SERVICE CORPORATION PLANS

H.R. 6410 would impose on all HR-10 plans certain restrictions previously applicable only to plans in which ten percent or greater owners were participants. Similar rules would apply to ten percent or more shareholders of personal service corporations. For example, all self-employed participants would be prevented from receiving distributions before age 59½ as would all shareholders of a personal service corporation.

These companies would be denied the benefits of the 4-40 vesting safe harbor specified by the ERISA Conference Committee and protected by subsequent Congressional action (House Joint Resolution 644, P.L. No. 96-536). All HR-10 plans and all plans maintained by personal service corporations which cover shareholders would be required to provide full and immediate vesting and full coverage of all employees with three years of service.

In addition, self-employed participants with a greater than ten percent interest in their companies and ten percent or more shareholders of personal service corporations would be subject to additional restrictions. These include a $100,000 limitation on the amount of compensation which could be taken into account in determining plan contributions (increased to $200,000 in certain circumstances where other employees receive at least 7.5 percent of pay as a plan contribution).

These proposals would have an impact on many small businesses and would also affect a number of larger businesses in the personal service field. Personal service corporations would include corporations performing any services in the fields of health, law, actuarial science, accounting, architecture, engineering, consulting, athletics, and performing arts.

The principle of parity between HR-10 plans and corporate plans would reduce the tendency of small business to incorporate simply for retirement plan purposes when a partnership form would otherwise be more appropriate. There should be little or no revenue impact brought about by the introduction of parity because of the present availability of incorporation as a method for obtaining higher contribution and benefit limitations. However, preserving and expanding the applicability of these overly complex and costly rules to a greater number of HR-10 plans and to plans maintained by personal service corporations is inadvisable. The 4-40 vesting rule represents a reasonable compromise which has been carefully worked out over the years and has been confirmed by Congress on more than one occasion.

Most small corporate plans and HR-10 plans already cover virtually all common law employees because of the nondiscrimination requirements of the Code. Therefore, these new more restrictive rules will accomplish little in terms of broadening the coverage of such plans and will fall most heavily on the larger personal service corporations which have never previously been subject to the complex HR-10 rules. In an area where there is already excessive complexity, there is value in simplicity. A better approach would be to establish total parity between HR-10 and corporate plans by increasing HR-10 limitations to correspond with the corporate plan limitations and by deleting the other HR-10 qualification and benefit distribution requirements.

E. SOCIAL SECURITY INTEGRATION

New restrictions would apply to plans integrated with Social Security. Beginning in 1985, the maximum integration of a defined contribution plan would be achieved by a formula that provides a reduction based upon the prevailing taxable wage base and the prevailing tax rate. Until 1985 an allocation equal to 5.4 percent of a participant's wages in excess of the Social Security taxable wage base would be permitted. (Under current law, a seven percent excess allocation is permitted.) Integration of defined benefit plans would be based on regulations which would limit Social Security offsets by basing the offsets on the Social Security benefits available from contributions solely by the employer maintaining the plan. (Under current law, the offset is determined with respect to the employee's estimated Social Security benefits earned with all employers.) A safe harbor rule would permit benefit accruals provisions which treat compensation between $0 and $30,000 per year and compensation in excess of $60,000 per year the same for benefit accrual purposes but which provide for benefit accrual at up to twice that rate for compensation between $30,000 and $60,000 per year.

These rules are likely to impose tremendous additional cost on plan sponsors, particularly employers maintaining defined benefit plans. This change is so far-reaching in its impact as to seriously threaten the continued viability of many retirement plans. At the very least, serious considerations should be given to the impact of the proposed integration changes prior to any further action regarding H.R. 6410.

An attempt was made to drastically limit integration as part of the Conference Report of ERISA. No hearings were held yet the Conference bill (H.R. 2) contained a provision comparable in effect and intent to the provision contained in H.R. 6410. Because of the intense protest at the time, the House and Senate took the extraordinary step of adopting the Conference bill and amending it at the same time. *See,* H.R. 2 Sec. 1021(g); House Conf. Rep. 93-1280 at 131, 280-81, H. Con. Res. 609 Sec. 2(17); BNA Daily Executive Reporter, No. 162, G-2 (Aug. 20, 1974).

F. ESTATE TAX EXCLUSION

The estate tax exclusion for qualified plan distributions would be limited to $500,000. (No limit under current law.) Because of recent changes in the estate tax this modification in the estate tax inclusion would have very little impact on most estates. By the same token, it should produce very little additional revenue in the foreseeable future. However, in order to preserve the role of the estate tax exclusion as a potential tax incentive in those cases where it does apply, it would appear advisable to retain the present estate tax exclusion provisions. The Committee should study the impact of this proposal further.

G. FRINGE BENEFITS

Certain statutory fringe benefit plans (group term life insurance, self-insured accident or health plans, group legal service plans, van pooling plans, education assistance programs, and dependent car assistance programs) would be subject to a mechanical test for detecting prohibited discrimination in favor of officers, five percent owners and the highest paid 15 percent of all employees ("Key employees"). A fringe benefit plan would satisfy the nondiscriminatory coverage test if (1) the plan benefits at least 70 percent of all employees; (2) at least 85 percent of all participating employees are not key employees; or (3) the plan benefits a nondiscriminatory class of employees. Employees excludable from consideration include employees with less than three years service, part-time employees, collective bargaining employees and non-resident aliens. In addition, the amount of benefits available to participating key employees must be available to all other employees, except that group term insurance can vary on the basis of compensation. If the plan is found to discriminate, key employees would recognize income on their pro rata share of the benefits.

These changes would have significant impact for employers of all sizes and in particular large employers. As was discussed above in connection with loans, the 15 percent requirement with respect to key employees may prove difficult to administer and should be modified under the proposal. These modifications would further limit the extent to which employers have flexibility in designing compensation systems. Any determination of discrimination based upon utilization will create tremendous hardship for employers attempting to police the operation of their fringe benefit programs. The result may well be a drastic reduction in such programs with a loss of protection now offered to employees. Such a development would be contrary to the best interests of our nation's work force and may defeat the objective of broadening coverage under fringe benefit programs. Certainly, this proposal requires extensive further study regarding its impact. Similar proposals have been considered by Congressional committees in the past.

STATEMENT OF THE CHICAGO ASSOCIATION OF COMMERCE & INDUSTRY

INTRODUCTION

The Chicago Association of Commerce and Industry (CACI) wishes to present its views on the Pension Equity Tax Act of 1982 (H.R. 6410).

The Chicago Association of Commerce and Industry is a voluntary organization of business and professional leaders working together to promote the commercial and industrial growth of Metropolitan Chicago and to foster civic improvements that benefit the general welfare of all who live and work in the area The area includes Cook, McHenry, Lake, Kane and Will Counties in Illinois and Lake and Porter Counties in Indiana. The Association is the principal representative of the Chicago area business and industrial community and represents 5,500 business and 12,000 individual members, who employ over 1.2 million workers.

The Chicago Association of Commerce and Industry has thoroughly reviewed the Pension Equity Tax Act of 1982 (the "Bill") and urges that the Bill not be adopted for the follow-reasons:

(a) Contrary to one of the purposes expressed in the Bill, H.R. 6410 will not provide greater tax incentives for including employees in retirement plans but will actually result in curtailment of benefits and termination of such plans.

(b) Contrary to one of the other purposes expressed in the Bill, the private retirement plan system is not an entitlement or discretionary grant program, like Social Security, which is supported by transfer payments from tax revenues generated by working Americans but a system to induce employers to establish retirement plans for employees and to induce employees to save for their own retirement. To equate the two, and require some sort of parity between the two, is erroneous. Unlike certain entitlement programs, such as Social Security, benefits paid from private retirement plans are fully taxable and, while accumulating in trust, provide the largest single source of savings for investment capital in the country.

(c) To the extent the Bill is designed to enhance federal revenue, those provisions of the Bill which are not revenue producing should be removed. The projected loss of "savings" as a result of plan terminations and benefit curtailments, and the impact of such loss of savings on the financial markets also should be considered.

1. Tax incentives.—To the extent that the Bill further limits contributions to defined contribution plans and benefits from defined benefit plans and, at the same time, increases the cost of maintaining retirement plans, there will be less incentive for employers to maintain plans or to improve benefits under existing plans. Employers with employees who will be subject to the reduced Section 415 limitations (particularly the reduction for employees covered by more than one plan) will be careful to limit contributions to, and benefits from, such plans, thereby cutting back on the contributions and benefits for other rank and file employees. At the same time, the additional expense in amending plans to conform to the Section 415 limitations and limiting loans to highly compensated employees, and the additional cost in maintaining a plan as a result of the reduction in the amount of Social Security benefits which may be offset under a plan will surely prompt employers to consider the following:

(a) Do the benefits paid under such plans, and the contributions made to such plans, justify the additional legal, actuarial, accounting and recordkeeping expenses in maintaining the plans as a result of the continuous changes required in such plans?

(b) Should benefits under pension plans be reduced or curtailed because of the additional costs to be incurred in funding pension plans integrated with Social Security?

(c) Why does Congress continuously impose new restrictions in plans (i.e., limitations on the availability of loans to certain participants, reduction in combined defined benefit-defined contribution limits from 1.4 to 1.0, changes in Social Security integration procedures, unfair restrictions in plans maintained by professional corporations, new eligibility and coverage rules for welfare benefit plans) while at the same time failing to remedy the burden on employers in complying with reporting and disclosure requirements, fiduciary and other prohibited transaction requirements, and other problems arising under the Multiemployer Pension Plan Amendments Act of 1980, which have increased the cost of maintaining plans but done very little to increase the benefits under such plans.

The Bill should be carefully analyzed by the House Ways and Means Committee as to the ultimate impact of the Bill's adoption. The Chicago Association of Commerce and Industry believes that the Bill will not strengthen the private retirement system but will in fact further weaken it. This will put additional strain on a Social Security system which is already overburdened and will only enhance the nation's problems in providing retirement income to elderly Americans.

2. Retirement system as entitlement program.—The private retirement system is the backbone for providing supplemental retirement income to millions of Americans, while at the same time, providing the necessary capital for the Nation's business expansion and real estate development and for financing public and private debt. Unlike Social Security, it is not an intergenerational transfer payment, but a tax induced system of "savings." The system has worked well and Congress should be taking all actions necessary to improve and better the system rather than providing additional constraints on the adoption of new plans and additional costs and expenses in maintaining existing plans. The Bill will not promote adoption of new plans and can only result in the curtailment or termination of benefits under existing plans. In addition, whereas benefits paid to beneficiaries under the Social Security system are not taxable, all benefit payments from retirement plans are fully taxable when received by a participant or beneficiary. Thus, there is no way to compare other entitlement programs with the private retirement plan system and parity should not be a consideration. The Bill will not promote savings and subsequent taxable benefits.

3. Revenue enhancement.—If the primary purpose of the Bill is to increase federal revenues, the Bill should make only those changes necessary in the existing statutory framework necessary to accomplish this purpose. Although it is difficult to argue currently that a pension of $90,000 per year, or contributions of $30,000 per year to a defined contribution plan, is not reasonable for retirement purposes, there are numerous provisions in the Bill which will not enhance revenue in any appreciable amount and should be eliminated from consideration. For example, the restrictions on loans to key employees, for limitations in the integration of retirement plans with Social Security and the extension of various HR-10 rules to retirement plans of professional service corporations have little or no impact on revenue whatsoever. These provisions are designed to eliminate a perceived abuse in retirement plans which should not be considered with this Bill.

The Committee also should consider the overall affect that any changes in the private retirement system designed to increase tax revenues by decreasing tax deductible contributions to such plans will have on capital formation and the impact of such reductions in the amount available to provide retirees and their beneficiaries retirement benefits in subsequent years. With the Social Security system's continual funding crisis, and benefits increasing at a far greater rate than the working public's ability to pay for such benefits, the overall revenue impact of this Bill should be compared with the potential loss of savings for investment and the reduction in future benefit payments. It is also difficult to understand the revenue impact of this Bill in light of the fact that most of the provisions designed to increase revenue do not apply until years ending after December 31, 1983.

In summation, CACI believes that adoption of this Bill is not in the best interest of the Nation. The Bill will provide additional pressure on the Social Security system to provide retirement income to employees of employers who curtail benefits or terminate plans. The Bill also will increase drastically the expenses incurred and contributions necessary to maintain retirement plans at a time when American business cannot bear such additional cost and expenses. At the same time, to treat professional service corporations differently than other corporations unfairly affects the employees of such corporations. Such treatment will adversely affect the amount of benefits employees employed in the service industry can expect to receive at retirement. Contrary to the Committee's assumption, the service industry is the fastest growing industry in this country and will in the future employ more and more American workers with strong desires in securing interests in their employers' retirement plans for future retirement security. This Bill eliminates any "equity" for such corporations.

CACI fully supports provisions in the Bill which will raise the limits on tax-deductible contributions by self-employed individuals from $15,000 to $30,000. To require, however, that professional service corporations be subject to the same tax qualification requirements that self-employed individuals are subject to would be unfair, inequitable and will not foster the growth of retirement plans in that sector of the American economy.

THE CHICAGO BAR ASSOCIATION,
Chicago, Ill., June 8, 1982.

HOUSE WAYS AND MEANS COMMITTEE,
Longworth House Office Building,
Washington, D.C.

GENTLEMEN: The Chicago Bar Association, which is a professional association with a membership in excess of 15,200 attorneys, has reviewed H.R. 6410. The position of the Chicago Bar Association on H.R. 6410 is stated herein.

1. The Chicago Bar Association strongly opposes the enactment of Section 6 of H.R. 6410. This Section 6 would impose the restrictions applicable to tax qualified retirement plans covering self-employed individuals on corporations which provide professional, performing arts and athletic services, and thereby unfairly singles out a class of corporations for discriminatory treatment under the federal income tax law. There are no supportable policy reasons for imposing greater restrictions upon corporations which perform certain services than other corporations.

2. The Chicago Bar Association strongly opposes the enactment of Section 5 of H.R. 6410. This Section 5 would impose many of the restrictions presently applicable to tax qualified retirement plans covering self-employed individuals with a more than 10 percent interest in capital or profits ("Owner-Employees") on tax qualified retirement plans covering any self-employed individual regardless of how small his ownership interest in capital or profits. Section 5 inappropriately emphasizes the form of an entity, rather than any demonstrated substantive need for further regulation.

Historically, more restrictive rules have applied to tax qualified retirement plans covering Owner-Employees because of a concern that proprietorships and partnerships owned by a small number of partners might manipulate the eligibility rules, vesting rules, contribution formulas and distributions in an improper manner. In the case of plans covering no Owner-Employees, (generally plans of a partnership with more than 10 partners), the entities maintaining such plans are institutionalized and unlikely to engage in improper manipulation of qualified plans.

Indeed, in the case of large accounting, consulting, law and certain other partnerships, such partnerships are substantially more institutionalized and less likely to manipulate the use of tax qualified plans than many small corporations the ownership of which is concentrated in a small number of share-holder-employees.

Section 5 of H.R. 6410 would, if enacted, result in a significant step backwards by making the form and not the substance of an entity govern the rules applicable to its tax qualified retirement plans. Under that Section, tax qualified retirement plans of large partnerships with no Owner-Employees would:

(a) Be required to provide 100 percent immediate vesting, while plans of corporations could require from 10 to 15 years for full vesting;

(b) Be prohibited from requiring that employees attain a specified age as a condition of eligibility, while plans of corporations could require any age up to 25;

(c) Be prohibited from providing that the amount of contributions to a profit sharing plan could be determined annually, although corporations may determine the level of profit-sharing contributions annually; and

(d) Prohibit distributions to partners (for example upon the termination of a partner's employment and ownership relationship with his firm), while corporations are permitted to make distributions upon an employee's termination of employment.

It has not been established that large partnerships are more likely than corporations to manipulate their tax qualified retirement plans in order to support this disparate treatment.

3. The Chicago Bar Association opposes the enactment of Section 2 of H.R. 6410 until there has been adequate consideration of the potential adverse impact such changes could have upon retirement and other benefits.

Section 2 of the Bill would, among other things, (i) reduce an individual's maximum permitted level of annual contributions to $30,000 (from $45,475 in 1982) (ii) reduce an individual's maximum permitted annual retirement benefits to $90,000 (from $136,425 in 1982), (iii) reduce the combined limitation for persons participating in both types of plans to 100 percent (from 140 percent currently), (iv) eliminate present annual cost of living adjustments to those limitations, and (v) reduce permitted benefits by the value of post-retirement medical, hospital, accident and similar benefits.

The reduction in the maximum permitted contributions and benefit levels may adversely affect rank and file employees, particularly in plans maintained by smaller corporations. Such plans often are designed to provide key employees the maximum permitted levels of contributions or benefits. That design and the rules which require non-discriminatory contributions or benefits determine the contributions or benefits provided to all other employees. To the extent that maximum permitted contributions and benefits are reduced, the plan design required to provide the lower maximums to key employees will result in lower benefits being provided to all other employees. Further, in certain businesses the lower limitations may discourage the establishment or continuation of retirement plans.

Reducing maximum permitted retirement benefits by the value of post-retirement medical, hospital, accident and similar benefits may result in the elimination of such benefits from many plans. The loss of such benefits could be more disadvantageous to rank and file employees than to key employees.

Once the appropriate limits upon contributions and benefits are determined, proper indexing of such limits is important to assure the same balancing of objectives is continued. Failure to do so not only impacts key employees, but also may (as explained above) result in reduced levels of contributions and benefits of all other employees. If the reason for eliminating cost of living adjustments to the limitation amounts is dissatisfaction with the present index, a more appropriate index should be used (for example, average increases in wages or the GNP deflator). Further, it should be noted that contributions and benefits above the limitations may be provided to certain employees through unfunded, nonqualified excess benefit plans (which do not afford the protection of ERISA's funding requirements, government insurance of benefits and nonforfeitability standards). Without indexing, continued inflation would geometrically increase the number of persons and amounts of benefits which would be denied those protections.

Therefore, the Chicago Bar Association recommends that action not be taken on Section 2 until there has been sufficient time for more complete study and comment by the general public and the affected businesses.

4. The Chicago Bar Association opposes the enactment of Section 3 of H.R. 6410, which would treat loans to any employee under cash and deferred plans and loans to key employees of any other plans as taxable distributions, until there has been adequate consideration of (i) the potential adverse effects such changes would have upon the amount of funds committed to retirement plans, (ii) the socially desirable reasons for permitting untaxed loans from retirement plans (such as emergencies, college education or home purchase), (iii) the likely loss of the availability of loans for rank and file employees, and (iv) that taxation of loans will likely result in plan distributions (rather than loans) which will not be repaid to restore employees' retirement benefits.

One of the basic principles applied to tax-qualified retirement plans is equal treatment for all participants. We question the appropiateness of providing less favorable income tax treatment for loans to key employees.

Taxation of loans from qualified plans could discourage the use of retirement funds for socially desirable personal needs, such as home ownership, college education or medical expenses. This could reduce the amount set aside in retirement plans and could permanently reduce the retirement savings of a person who has an interim need for the funds.

Although the extent of the undersirable consequences of taxing loans cannot be known without further study, one probable result would be that less funds may be available for retirement under a qualified plan. If loans to key employees are taxed as distributions, many plans will not permit loans to any employees. Further, if loans are taxed as distributions, profit sharing plans will provide for distributions (rather than loans) to all employees, which will not be repaid. If funds are prematurely removed from, or never paid into, the pool available for an employee's retirement, the employee will have less funds available at retirement.

Even if taxation of loans to key employees were appropriate, the Bill would include in the key employee group many employees who on an absolute standard would be middle income employees. H.R. 6410 defines "key employees" to include the most highly compensated 15 percent of employees of an employer. In many businesses, the most highly compensated 15 percent of employees may include a number of employees who are not highly compensated by most standards.

Further, H.R. 6410 would make loans to any participant under a cash or deferred arrangement (to the extent of the amount he has elected to defer) as taxable distributions. The effect will be to discourage employee retirement savings through cash and deferred plans.

5. The Chicago Bar Association opposes the enactment of Section 4 of H.R. 6410, which would make significant changes in the manner by which tax qualified retirement plans are permitted to coordinate contributions and benefits with Social Security contributions and benefits ("integration"). Section 4 should not be enacted until (i) Congress has the benefit of the final report of the National Commission on Social Security Reform, (ii) there has been careful consideration of the ability of employers to pay for benefits should there be a change in the integration rules, and (iii) the effects of such changes upon the contributions and benefits to all employees are more fully understood.

Section 4 of the Bill would radically alter the rules for the integration of qualified retirement plans with Social Security and certain other state and federal retirement programs. In general, the Bill would reduce the extent to which Social Security could be taken into account in establishing contribution or benefit levels in a qualified retirement plan. These changes would be imposed without the benefit of analysis of their real effects on the private retirement system.

It is generally acknowledged that there is, in the United States, a tri-partite system of providing retirement benefits (sometimes referred to as a three-legged stool). Retirement benefits are provided under the Social Security system. under private employer-provided pensions, and from personal savings. A change in the level of benefits provided under one part of the tripartite system will affect the portion of retirement benefits that must be provided through the other two. The National Commission on Social Security Reform, which presently is studying the Social Security system in order to recommend short-term and long-term changes, has not made its final report. Any changes in the coordination of contributions and benefits of private retirement plans with Social Security taxes and benefits, prior to consideration of the final report, would be premature.

The apparent premise of Section 4 of the Bill is that by reducing the permitted level of integration with Social Security, Congress will encourage the private pension system to provide larger pensions to employees. We note that the possibility of prohibiting integration with Social Security was considered at the time Congress considered ERISA. At that time it was recognized that further study was needed, and that reduction or elimination of integration would not benefit imployees as a whole: "[Y]our committee is very much aware that many present plans are fully or partly integrated and that elimination of the intergration procedures could substantially increase the cost of financing private plans. Employees, as a whole, might be injured rather than aided if such cost increases resulted in slowing down the growth or perhaps even eliminated [sic] private retirement plans." 2 Subcommittee on Labor of the Committee on Labor and Public Welfare, 94th Cong. 2d Sess., Legislative History of the Employee Retirement Income Security Act of 1974, at 3189 (1976).

Apparently, no study of these possible effects has been completed. Therefore, these Congressional observations of the dangers of such changes continue to have validity.

6. The Chicago Bar Association opposes the enactment of Section 7 of H.R. 6410, which would impose certain requirements upon participation and levels of benefits under certain statutory fringe benefit plans, until there has been a thorough study and consideration of (i) these plans, (ii) the limited levels of tax benefits available and (iii) whether the costs and difficulties of compliance with the proposed changes would result in cancellation of many of these benefits by many employers.

Section 7 of H.R. 6410 would impose complex eligibility and coverage rules (similar to those which apply to tax qualified retirement plans) upon certain statutory fringe benefit plans.

The types of fringe benefits to be covered are diverse and complex. Plans have been provided in highly individual circumstances. The fringe benefits have been given favorable tax treatment because of their social desirability. This Bill would attempt to impose a uniform set of rules without full consideration of the probable impact of those rules on the continued viability of the fringe benefit plans. Generally, statutory fringe benefit plans are provided by employers because of their simplicity and relatively low cost. The rules set forth in the bill would impose significant administrative and compliance costs on employers similar to those experienced with regard to tax-qualified retirement plans. Given the nature of the plans, the value of providing the benefits in many instances may be too small compared with the cost of compliance with the rules set forth in the Bill. Many employers may not establish or may discontinue many of these plans rather than bear the administrative and compliance costs.

7. The Chicago Bar Association opposes the enactment of Section 8 of H.R. 6410, which would limit the estate tax exclusion for death benefits from tax qualified retirement plans and individual retirement accounts to $500,000. Section 8 should not be enacted until there has been careful consideration of (i) the fact that many individuals who have already received distributions from tax qualified plans have made irrevocable decisions to give up favorable income tax treatment to make rollover contributions in reliance on present law and (ii) the likely impetus toward lump sum distributions rather than extended payments ouver a period of years (both because of the availability of more favorable income tax rules and because otherwise there would be a requirement of immediate payment of estate taxes from funds not payable until the future).

Section 8 of H.R. 6410 would put a limit of $500,000 on the value of a qualifying distribution from an employer-sponsored retirement plan which may be excluded from the employee's estate. The impact of this provision requires further study. It is expected that this limitation will result in the election of lump sum distributions wherever possible, in order to take advantage of favorable income tax rules and to assure the availability of funds needed to pay increased estate taxes. By thus favoring lump sum distributions, the Bill would discourage an employee from electing to receive income over the life of the employee and his spouse.

Further, limiting the estate exclusion will defeat the legitimate expectations of persons who have already made irrevocable decisions with respect to the distribution of their plan benefits. Individuals who have received distributions and who have elected to make rollover contributions have relied upon future estate tax exclusions. In making these decisions these individuals have irrevocably lost the ability to claim capital gains and 10 year averaging income tax treatment on the distributions. Any new limitations on the level of estate tax exclusion should make adequate provision to preserve the reasonable expectations of individuals who have made irrevocable planning decisions relying upon present law.

If further information on our position is needed, please contact Roger C. Siske, Sonnenschein Carlin Nath & Rosenthal, 8000 Sears Tower, Chicago, Illinois 60606, telephone (312) 876-8010.

Very truly yours,

KEVIN M. FORDE, *President.*

CITIBANK, N.A.,
New York, N.Y., June 18, 1982.

Hon. DANIEL J. ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR REPRESENTATIVE ROSTENKOWSKI: This statement for the record of your hearings on H.R. 6410 is submitted by Citibank, N.A., which has for many years maintained a qualified retirement plan which includes a cash or deferred arrangement. We wish to address the provisions of section 3 of H.R., 6410, which would ban loans to participants under our plan. This issue has received scant attention, to our knowledge, in the comments filed to date. Our practical experience with this plan provides a needed perspective on this issue.

Cash or deferred plans have historically confronted the problem of achieving a sufficient deferral rate among lower-compensated employees. This reflects the economic reality that in general lower-compensated employees have relatively greater immediate demands on their income than do higher-compensated employees. However, this is not true for all employees at any given income level, and cash or deferred plans are an effort to accommodate to these varying financial circumstances. It is therefore a more responsible and responsive compensation policy to permit employees to consider their individual situations, rather than to impose income deferral for all employees by employer fiat as in a normal profit-sharing plan.

The consistent and overriding concern of lower-compensated employees, in our experience, has been access to their accounts in the event of an emergency. For these individuals, the election to defer will in many cases constitute a decision to use the cash or deferred plan as their primary savings vehicle. While a hardship provision will still be permitted in a cash or deferred plan, the reasons for which a hardship withdrawal may be granted under IRS rulings do not cover many of the real financial hardships which may occur. Thus the choice for these individuals is between savings vehicles which provide no tax advantages but allow ready access, and the cash or deferred plan which provides a greater financial benefit but restricted access.

For this reason, we believe that the prohibition of participant loans threatens the continued existence of our plan. Cash or deferred plans already labor under the Code Section 401(k)(2)(B) prohibition, not imposed on other plans, that no distribution may be made to a participant prior to termination of employment. If loans are now to be forbidden, the rank and file employee must regard an election to defer as locking away his savings beyond his reach. The employee's situation is significantly worse than if he had made a deposit into an IRA. In an IRA (with which this proposal has been erroneously compared), the employee could get to his money if he absolutely had to at the cost of a 10 percent penalty. In a cash or deferred plan, the consequence of such a distribution is disqualification of the entire plan: none will be made. We are convinced that if loans are disallowed, lower-compensated employees will reject deferral in numbers that will make it impossible for many plans to meet the actual percentage deferral tests of Code Section 401(k)(3).

In our view, the cash or deferred loan prohibition in section 3 of H.R. 6410 is an overly broad attempt to solve small plan abuse situations. None of the gamesmanship described in the comments takes place in broad-based plans such as ours, and none has been alleged. Real loans are extended to everyday people, in conformity with the strict ERISA fiduciary requirements. Rank and file employees are given an opportunity, otherwise unavailable as a practical matter to individuals in their income brackets, to accumulate a retirement nest egg by tax-deferred saving. Since loans must be repaid, as contrasted with an outright distribution, these retirement savings are preserved for their intended purpose. In addition to this personal benefit, the economy as a whole benefits by the resulting increase in capital formation and reduced pressure on Social Security. We believe these plans are worth preserving.

We also note that the effective date of this provision, May 19, 1982, will cause our plan to be disqualified if it is not changed. By the time we learned of this provision, May 19 had already passed, and loans were made after that date. In our view, this is an unjustifiably punitive provision. Our employees elected to defer under a set of rules governing their accounts upon which they had every right to rely, and we can not justify even now turning away loan applicants because of a single pending revenue bill. Changing the rules at this point violates fundamental rules of fairness. Even the Code Section 401(k)(2)(B) prohibition on pre-termination distributions was made effective only for allocations to individual accounts made for years after the effective date of the new law. We strongly urge that a similar effective date provision be adopted for any changes to the rules on loans.

If there are abuse cases in the area of loans from qualified plans, it is of course incumbent upon Congress to take corrective measures. However, where the matter at hand has a direct effect on the ability of individuals to provide for their retirement years, we believe that there is also a special responsibility to avoid unnecessary damage to the interests of participants in general. We have heard no evidence that the contemplated restrictions on loans from other types of plans to deal with the perceived abuses would not be equally effective for those plans which happen to contain a cash or deferred arrangement. We therefore urge that whatever the rules regarding participant loans which may be eventually adopted, those rules should apply no differently to cash or deferred plans than to other types of plans.

FREDERICK A. ROESCH,
Senior Vice President—Personnel.

CLARK, MIZE & LINVILLE, CHARTERED,
Salina, Kans., June 9, 1982.

JOHN J. SALMON,
Chief Counsel, House Ways & Means Committee,
Washington, D.C.

DEAR MR. SALMON: This is not another of those scores of letters you have received criticizing H.R. 6410, Rep. Rangel's "Pension Equity Bill." Yes, I am generally opposed to the bill, but I am most concerned about a little-known provision that has not received enough attention. H.R. 6410 would require bank trustees for all small retirement plans. This is an absolutely senseless requirement for self-trusteed retirement plans that permit self-directed investment.

A brief bit of background would be helpful at this point. Act § 404(c) of ERISA specifically encourages plans to permit each individual participant to direct the investment of his or her own plan account. In our own firm, for example, we have a simple self-trusteed profit sharing plan with 15 participants, each of whom exercises exclusive control over the investment of his or her account. Collectively, the 15 participants direct over 100 active assets (stocks, bonds, mutual funds, certificates of deposit, etc.). Plan transactions are conducted "internally" on a frequent basis with a minimum of hassle and at no expense to either the firm, the plan, or the individual participants.

H.R. 6410 would require us to hire a bank to "trustee" our plan, even though the participants would still be directing the investment of their own accounts. There are a number of compelling reasons why this should not be so:

1. Imagine the administrative hassle it will take to get each and every one of our 100+ plan accounts retitled in the name of a bank trustee.
2. As if that's bad enough, imagine the additional hassle if we should ever decide to change banks.
3. Imagine the hassle each individual participant will have to go through every time he wants to make an investment decision regarding his accounts. Suppose, for example, a participant decided to withdraw some money from his money market fund to buy a listed stock. He would have to call the bank, talk to a trust officer (if one happened to be in the bank at that time), instruct the officer to call a stockbroker, and further make arrangements for the officer to sign the redemption draft from the particular money fund in question. The potential here for confusion and mistakes is endless.
4. Naturally, the bank trustee will charge a fee for executing each of these transactions, even though it is acting purely as a custodian and has no fiduciary responsibility whatever.

The expenses and hassles outlined above are totally unnecessary and unreasonable in the context of a self-trusteed, self-directed plan. We strongly urge you to draft an exception to the bank trustee requirement along the following lines: ". . . except that bank trusteeship shall not be required to the extent that a plan permits self-directed investment within the meaning of Act § 404(c)."

Thank you in advance for your consideration and cooperation.

Very truly yours,

PETER L. PETERSON.

CONAHAN & CONAHAN,
Honolulu, Hawaii, May 21, 1982.

Mr. CHARLES B. RANGEL,
Representative of New York,
Rayburn House Office Building,
Washington, D.C.

Mr. ROBERT DOLE,
Senator from Kansas,
Dirksen Senate Office Building,
Washington, D.C.

GENTLEMEN: Although H.R. 6410 is technically Representative Rangel's bill, we are addressing this letter to Senator Dole as well because based on recent news stories, we assume Senator Dole will be sponsoring a similar bill in the Senate. This bill should be called the Pension Destruction Bill of 1982.

Our office represents approximately 1,300 pension plans for small business throughout the State of Hawaii and on the mainland United States and Alaska. If this bill—which we consider the most ill-conceived piece of legislation we have ever read—passes, 95 percent of our clients will close down their pension plans immediately and deprive approximately 11,000 employees of significant pension benefits. In that event, the employees will have to depend on social security for their pension; as you know the social security system is in a state of near bankruptcy.

Any Congressman or Senator who votes for this bill will be voting to deprive thousands and thousands of employees of their pension benefits. This bill is a bill aimed against small businesses and—make no mistake about it—small business will resent it tremendously. Many small businesses have been able to attract good employees because of the promise of a future pension benefit; these employees will be deprived of their benefit because many pension plans will be closed down.

The bill ironically curtails pensions in the private sector and effectively requires the close down of pension plans in many small businesses. We suggest that if you are honestly proposing this bill, you propose it so it applies to pension plans of all Senators, Representatives, and employees of the federal government. The federal pension plan exceeds in many respects the limits imposed on small businesses by the proposed Pension Destruction Bill of 1982 (e.g., the Federal employees benefit is indexed to cost of living increases each year). There is another crucial difference between the private pension plans maintained by small businesses and the federal pension plan. Small businesses earn the money they put in their pension plans for their employees; the federal government only has to tax the small businessman to provide the enormous pension plans that all federal employees enjoy.

We think that it is outrageous Congressional conduct to propose this bill. Small businessmen must pay social security taxes for their employees and they must pay those taxes into a system that is functionally bankrupt. Congress has specifically exempted all federal employees from the social security system. Now Congress wants to cut down the small business pension plan and continue to allow federal employees pensions that will not be allowed to small business under the Pension Destruction Act of 1982. We think it is outrageous for you to restrict the pension benefits for employees in the private sector while you and other federal employees are the recipients of one of the best pension plans that exist in the United States.

Many federal employees retire with a tremendous pension benefit and then join the social security system for a minimal period to get an additional social security benefit. Congress has failed to prohibit this "double dipping" (even though it is a key reason the social security system is nearly bankrupt), yet you are again proposing discrimination against small businesses by requiring private pension benefits to be inferior to the pension benefits provided all federal employees; small businesses do not want a replay of the social security-type discrimination the federal government has practiced over the years.

Our small business clients and their employees will be incensed by this bill. We would like to inform you that very few, if any, of our clients or their employees would ever vote for a Senator or Representative who support this bill.

Let us speak about our own law firm. Our costs of providing pension benefits for employees is very high. We are happy to provide those benefits under the current rules because they allow us to provide benefits for employees that stay with our firm for a reasonable period of time. If H.R. 6410 passes, we will have to consider terminating our pension plan (which covers two "bosses" and twelve other employees).

When a small business sets up a pension plan, it takes profit it has earned by virtue of its productivity and reallocates that profit so that it is redistributed among the employees of the small business in the form of pension benefits. It is true there is a significant tax deduction involved, but all of the qualifying employees of the small business must be covered by the plan. You do not have to worry about this since your employees' pension plans are fully paid for by the taxpayers, a large percentage of which are small businesses.

The money that is contributed is placed in a trust fund and earmarked for the employees' benefit. The amounts contributed to the plan are invested various ways and become part of the capital infrastructure the United States needs to prosper in the years ahead. American business must borrow over one trillion dollars in the next decade to remain competitive. If you close down the pension plans of the small businessman as a source of borrowing, you are injuring the industrial capacity of the country.

On behalf of our clients, we particularly dislike the bias against small business contained in the H.R. 6410. Although the small business has not had an effective lobbying group in the past, you should realize that small business provides a majority of new jobs in the country. The Small Business Council of America and similar groups intend to make the voice of small business heard in the future.

The proposed bill attempts to mandate massive funding for short term employees of private pension plans of small businessmen. It fails to recognize one essential truth: the private pension system is voluntary not mandatory. If the bill passes, many of our clients will simply close down their pension plans.

Instead of small business sharing their profits with their employees and saving these profits so that the total capital made available by the small business pension plans in the United States increases, businesses may terminate their plans and may be tempted to become involved in tax shelters that produce no social benefits but which promise large tax deductions.

Our specific comments on the Pension Destruction Act of 1982 follow:

(1) You reduce the deductible contribution to defined contribution plans to $30,000. You reduce the benefit allowed in a defined benefit plans to $90,000. You combine this with a repeal of any cost of living indexing of these limits. As we understand the federal pension system, you are entitled to cost of living increases; it bothers our clients, their employees, and us that you are repealing this benefit in the private sector only.

(2) You eliminate the 1.4 rule.

(3) You provide that benefits are reduced if an employee retires prior to age 65; our understanding of the federal pension system is that it allows an employee to retire at age 55.

(4) The bill prohibits loans to key employees, that is those persons who own 5 percent or more of the company or those persons who are highly paid. We state unequivocably that some of the best pension investments made by small business plans are loans to employees. We cannot see any rationale whatsoever to disallow loans to employees of a plan given the fact that the current law requires adequate security, fair rate of interest and non-discrimination. With the high cost of housing, a pension loan may be the only way an employee is able to afford a down payment on a home, especially in Hawaii where the average house costs in excess of $240,000.

(5) The bill changes the social security reduction integration provisions.

(6) The bill places a limit on the estate tax exclusion.

(7) There is a final provision of the bill which discriminates (something that pension laws generally do not allow) against professional service corporations in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. That provision which is unfairly aimed at the professional service corporation would:

(a) Require full vesting after an employee is employed for three years;

(b) Prohibit integration with social security;

(c) Require a bank trustee;

(d) Prohibit voluntary contributions;

(e) Prohibit payment prior to the age of 59½ without a time penalty;

(f) Require payments after age 70½;

(g) Require a defined contribution limit of 15 percent of pay or $30,000, whichever is less.

There is one provision of the bill that we agree with and that provision increases the Keogh limits to $30,000. In the past, Congress has required businesses to incorporate in order to obtain certain pension benefits for their employees and this is not sensible. You should equalize the benefits, but equalize them by raising Keogh limits to the currently allowable corporate limits and by allowing Keogh plans the same flexibility that corporate pension plans are now allowed.

We are particularly incensed with Senator Dole's attitude, since he is a Republican and presumably in favor of small business. For Senator Dole and you to support a bill which attacks the most productive members of American society, the small businessman, and which attacks the benefits provided to the employees of small business plans, is an outrage beyond comprehension.

The small businessman of America has been inadequately represented in Congress. Too often, small businesses have been Congress' scapegoat. This will change. You are on notice that virtually all of our clients will vote against any Congressman or Senator that even hints at supporting HR-6410 (except insofar as it increases Keogh limits).

We think that it is absolutely unAmerican of you to pick on small businesses this way. We and our employees bear the brunt of the enormously unfair tax system you have enacted over the years. Yet we are the people that support the federal government through our revenues. We demand you cut taxes, cut the number of Federal employees, cut your own pension benefits, and impose the social security system on all federal employees immediately. This attempt to discriminate against the small businessmen of America is absolutely outrageous.

Sincerely yours,

JAMES P. CONAHAN.
KATHLEEN K. O. CONAHAN.

STATEMENT OF MARVIN A. LEVINS, SENIOR VICE PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE CO.

I am Marvin A. Levins, Senior Vice President of the Group Pension Operations of Connecticut General Life Insurance Company, a company of CIGNA Corporation, the second largest stockholder-owned insurance company in the United States. Connecticut General handles over 20,000 pension plans covering one million employees and over $11 billion in assets. CIGNA supports the efforts of this Committee and the Congress to find the revenues needed to reduce projected Federal deficits to the point where permanent economic recovery can be assured. H.R. 6410, however, would impose costs and burdens throughout the American work force that far outweigh the value of any revenues it would raise.

General concerns with H.R. 6410

The post-retirement income system is not a monolith. It consists of three equally vital components: private pensions, Social Security and personal savings. Important steps were taken last year to encourage personal savings, which are particularly important in view of the short and long term pressures on Social Security. Any changes in the private pension system should also be directed toward strengthening the post-retirement income system. However, enactment of H.R. 6410 would represent a step backward, by seriously weakening the private pension component of the system and by adversely affecting statutory benefit programs. The bill reverses prior public sector commitments to encouraging private pensions which were inherent in ERISA, as well as subsequent private savings legislation.

We must encourage efforts such as the savings incentives in the recent Economic Recovery Tax Act to increase individual savings and reduce our future reliance on Social Security. Since the relationships among personal savings, private pensions and Social Security are complex, changes in any one area affect the balance among all of them. We are already engaged in serious debate on proposed amendments to ERISA and Social Security reform. The provisions of H.R. 6410 should be considered within these debates.

All of us must also recognize that pension plan sponsors have been barraged with Federal regulatory and reporting requirements from numerous sources. Small employers, particularly, feel the cost and administrative burdens associated with each change in government rules and red tape. Each change increases costs relative to the benefits derived from a pension plan and drives plan sponsors a step closer to deciding that maintaining a plan is simply not worth the burden. Small business owners who can afford private plans also have access to other means of providing for their own savings for retirement; however, their employees are left with very limited options.

We at CIGNA believe that H.R. 6410 should not be acted upon hastily, but rather considered in the broader context of needed changes in the post-retirement income system, and recognizing that any change in the system imposes many costs. We wish to submit the following analysis of the impact of the individual provisions of H.R. 6410, illustrating the broad and often unintended effects the bill would have, and demonstrating the need to proceed cautiously in effecting major changes in the post-retirement income system.

Limits on contributions and benefits

Under present law, deductible employer contributions to a qualified profit-sharing or other defined contribution plan cannot exceed the lower of 25 percent of compensation or $45,475 for each participant. The maximum annual benefit payable under a defined benefit plan is the lower of 100 percent of compensation or $136,425 for life, beginning at age 55. The limits are automatically adjusted annually for increases in the cost-of-living.

H.R. 6410 would reduce these limits to $30,000 and $90,000 respectively, eliminate the cost-of-living adjustments for these amounts, and require that the $90,000 limit be reduced if benefits commence before age 65. The bill would also reduce the current aggregate limit of 1.4 times the separate defined benefit and defined contributions limits to 1.0.

While it is easiest to see the direct effects of these benefits and contribution limits on a relatively few highly compensated individuals, these changes would have effect in both the short- and long-run on all plan participants. Employees rely heavily on their employers' pension plans as a major source of retirement income in addition to Social Security. Over 75 percent of plan participants in the smallest (under 10 life) groups are not owners or key individuals, and in larger groups, the percentage of rank-and-file employees is far higher.

The impact of these provisions would be to discourage the formation of new plans, particularly in small employer settings, and even to encourage the termination of plans. Studies of plan terminations in the two years following passage of ERISA show, generally, that 30–35 percent of plan terminations had, at least, some ERISA-related reasons, and 15–20 percent were solely due to ERISA. This evidence demonstrates that continued additional restrictions and changes imposed by major pension legislation contribute to plan terminations.

Reducing the 1.4 aggregate limit is targeted at the highly paid employees, but would also hamper the efforts of rank-and-file workers to save, since they would also be subject to a lower aggregate limit. Particularly impacted would be the voluntary investment and thrift programs that provide an important complement to defined benefit plans. Our studies demonstrate that voluntary savings plans are utilized by a broad cross-section of employers, not just those who are highly paid. H.R.

6410 would create an incentive for many firms to limit themselves to a single defined benefit plan, rather than to operate two plans with all the additional requirements that are involved. Vesting under defined benefit plans may take up to 10 years, while vesting in thrift plans is usually much shorter. If employers are encouraged by statutory disincentives to terminate defined contribution plans, we would be limiting severely the savings opportunities of today's more mobile workers.

Eliminating the indexing of the Section 415 limits will also have a long term effect on the rank-and-file participants. For example, if the inflation pattern of the last 5 years holds for the next 20, 20–50 percent of participants in defined benefit plans would have their benefits limited by the proposed $90,000 limit. As another example, under a typical pension program an employee age 25 who retired under that program would have his pension restricted by repeal of the cost-of-living adjustment if he currently earns only $13,000.

We should also consider the signal being sent in the proposal to reduce the $90,000 limit if benefits commence prior to age 65. The question of retirement age under all programs and any possible adjustments to benefits resulting from early retirement needs to be addressed in the broader context of Social Security reform. This debate must include both a recognition of changing life expectancy and lifestyle, and the need to reduce our future reliance on Social Security. This debate will be initiated later this year when the National Commission of Social Security issues its report. Taking any action in this area now would be premature, and would leave open other questions which should be answered at the same time. For example, if the benefit limit is to be reduced if benefits commence prior to age 65, perhaps they should increase if work continues past 65. Similarly, we should consider if Federal civil service workers, who now can retire on full pension benefits at age 55, should be included in the restructuring of this aspect of the pension system even if their separate system is retained.

Loans to plan participants

Under present law, all loans from plans to participants are subject to specific regulatory requirements. Loans must be available to all plan participants on a comparable basis; a reasonable interest rate must be paid, and adequate security must secure the loan. H.R. 6410 would treat loans from all plans to "key employees," including the highest paid 15 percent of employees, as plan distributions, which, in effect, would prohibit loans to this group. The additional restrictions of H.R. 6410 are unnecessary, and should be rejected. The Internal Revenue Service and Department of Labor already have adequate authority to deal with abusive and discriminatory plan loan practices.

Unfortunately, under this proposal, many middle income employees will be treated as "key employees" because they are among the highest paid 15 percent of their employers' work force. In the case of large employers, hundreds of, and certainly, in very large employers, a few thousand workers will be "key employees" and will be disadvantaged. Prohibiting loans to higher paid employees will cause many plan sponsors to eliminate loans (or to not provide for loans) to all employees in the plan. Lower and middle income workers may be unwilling and unable to commit funds to retirement savings without a loan "safety net" for emergencies. Therefore, the anti-loan provision initially directed at key employees may produce a saving disincentive for rank-and-file workers.

Integration with social security

Present law prohibits a qualified plan from discriminating in favor of highly compensated employees in terms of plan contributions or benefits. In measuring plan contributions or benefits for an employee, a portion of his Social Security retirement benefit may be taken into account as if provided under the plan. This permits the employer to reduce plan contributions or benefits for the employee, so that the plan supplements, rather than duplicates, the employees' Social Security retirement benefits.

H.R. 6410 would continue to allow an employer to reduce plan contributions or benefits on account of employer-provided Social Security benefits, but would, generally, limit the reduction to the actual cost of the employee's Social Security benefits borne by the employer. The changes proposed in this particular area should not be enacted without a great deal of further debate since they would affect more than 50 percent of all private pension plans in the U.S. Accordingly, the pension funding obligations of tens of thousands of large and small businesses and the benefits of millions of employees would be affected.

Private pension plans are diverse and complex, and Social Security integration is one of the most complex features of private plans. Experts agree that a sound approach to Social Security integration is a key element in the development of a national retirement income policy. An issue of this magnitude simply cannot be adequately considered at a time when budget and revenue decisions on issues of immediate economic importance are confronting the Congress. As previously noted, by the end of 1982, the National Commission on Social Security Reform will have developed recommendations for potentially major changes in Social Security. Since the impact of any such recommendations on employees' Social Security benefits and employer pension funding costs is unknown, piecemeal action on Social Security integration is premature and ill-advised.

Restrictions on partnerships and personal service corporations

The bill would impose special new restrictive rules on both partnerships and personal service corporations. These rules are unfair and create substantial problems, because they discriminate against individuals by reason of profession or form of organization. Such distinctions are arbitrary and inconsistent with sound pension policy. The net effect of these provisions are highly punitive on the businesses covered. Plan terminations, with major benefit losses to rank-and-file employees, will result. The bill will create new, complex and arbitrary distinctions in the law. The additional rules will add further unnecessary and arbitrary restrictions on plans operated by these entitles and will exacerbate the complexity of the Internal Revenue Code.

Statutory fringe benefits

H.R. 6410 would impose new non-discrimination requirements on employer-provided health, life insurance programs and other fringe benefit programs. These programs are working well by providing essential benefits to millions of U.S. workers and their families. No compelling justification has been presented for changing the law in this area and the proposed restrictions frequently will work against employees' interests. Further, the many issues and complexities presented by the bill in this area dictate that any proposals for changing the rules that apply to such widely-used programs should be deferred for more careful study.

In view of the highly diverse kinds of health and life insurance now in effect, it is extremely difficult to determine how employers would react to changes in the tax rules for these basic benefits, and how workers and unions would respond to the changes, etc. In a recessionary period such as the present, employers may well choose to reduce benefits to employees, rather than increasing them or even maintaining the status quo.

H.R. 6410 would have the highly undesirable effect of encouraging employers to submit their welfare plans to the IRS in order to be sure that their plans meet the new requirements. This will increase administrative expenses to employers and further strain the administrative resources of the IRS.

Employers whose plans were not in compliance with the new standards would be faced with the complex and uncertain job of allocating the cost of "non-qualified" benefits among the top 15 percent of their work forces. In the case of group welfare arrangements, such allocations would be very arbitrary and could well be unfair to different groups of employees.

The results of these changes would be serious and, on balance, not in the public interest. H.R. 6410 could be interpreted to require absolutely identical benefits for all employees. For small and medium sized employers, insurers would be forced to offer a much narrower range of products and services, and these employers would be forced to reduce or cease to offer the benefits they are now able to provide their employees and retirees. For large employers, H.R. 6410 may provide too great an incentive to abandon traditional group insurance for "flexible" or "cafeteria style" benefits. Under these programs, however, "key" employees would still be able to retain higher levels of benefit choices. To precipitate such a major shift to this relatively new employee compensation alternative, where operational experience is still necessary, would be premature. For both large and small employers, the incentives created by H.R. 6410 represent an inappropriate and undesirable intrusion of government into the employer/employee relationship.

Estate tax provisions

Under present law, amounts payable under qualified plans, certain tax sheltered annuities, and IRAs are generally excluded without dollar limits from a decedent's gross estate to the extent attributable to employer's contributions or deductible employee contributions. H.R. 6410 would impose an aggregate $500,000 limit on the estate tax exclusion attributable to these items.

This tax treatment would be counterproductive in many cases. Many plans are established after a business has matured and its owners are relatively close to retirement. The current exclusion thus can be an important incentive for the owners to establish a plan for themselves and their employees. However, the proposal would diminish this incentive to new plan formation.

Public policy objections

Pension funds provide one of the largest stable sources of long term capital formation. Discouraging new plan formation and encouraging smaller business owners to shift their own savings to other vehicles would inhibit important patterns of capital generation.

Private plans also provide a proven stable form of savings for retirement, compared to purely voluntary personal saving. A well planned and managed retirement plan will produce large amounts of long term savings and a more secure retirement income than if comparable amounts were left solely in the hands of individuals who may have difficulty not only saving, but also evaluating the investment risks and returns.

The potential net revenues to be raised by H.R. 6410 are small, particularly in the early years. Thus, there is no compelling fiscal argument for hasty enactment of H.R. 6410. The Committee must also recognize the possibility that individuals faced with a reduction in the amounts they can contribute to private pension plans may have available alternative means of savings that would also reduce their tax liability. Thus, the estimated additional revenues may not materialize. In addition, the administrative burden of Federal regulatory and reporting requirements cannot be emphasized strongly enough. The changes required by H.R. 6410 would add unnecessarily to this burden without raising significant revenues or solving serious problems.

Finally, and most important, the changes proposed in H.R. 6410 are too far-reaching to receive only limited consideration in a much broader budget debate. Important changes in ERISA are already being debated, and debate will continue next year. Implementing H.R. 6410 separately from other major ERISA changes would require plan sponsors to unnecessarily incur significant costs and administrative burden twice. The savings from combining the changes due to all these proposals would be real and significant. The progress would be undeniable.

Summary

In conclusion, let me state that although we accept the need for the Congress to consider all means of increasing revenues, we believe that the estimated revenue will not be raised by the bill. H.R. 6410, however, will do significant damage to the adequacy of retirement income for many Americans.

The changes embodied in H.R. 6410 are too far-reaching to be enacted hurriedly. The bill will be an administrative burden for plan sponsors, provide incentives for plan terminations, discourage new plan formulation and make personal saving more difficult for many workers. Therefore, H.R. 6410's extensive impact must be carefully considered and its provisions should not be enacted separately from other changes in the retirement system.

KENNETH G. MEUSER ASSOCIATES, INC.,
Washington, D.C., June 14, 1982.

Hon. DANIEL ROSTENKOWSKI,
Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the following five major life insurance companies, I am submitting the following statement in opposition to HR 6410, The Pension Equity Tax Act of 1982, and request this be included in the hearing record on this legislation. The five life insurance companies are: Connecticut Mutual Life Insurance Company of Hartford, Massachusetts Mutual Life Insurance Company of

Springfield, Mutual Benefit Life Insurance Company of Newark, New England Mutual Life Insurance Company of Boston and the Penn Mutual Life Insurance Company of Philadelphia. These five life insurance companies are major institutional investors of pension funds and are service providers for a large number of qualified retirement plans, many of which are plans sponsored by small employers. The five life insurance companies provide services to and issue insurance and annuity contracts to more than 73,000 qualified retirement plans. In addition, the five life insurance companies also provide group life insurance contracts to more than 71,300 employers. Both qualified retirement plans and group life insurance contracts would be affected by this proposed legislation.

While the stated purpose of HR 6410 is to provide greater tax incentives to encourage qualified retirement plans and other statutory fringe benefit plans, the collective judgment of the five life insurance companies is that enactment of this legislation will discourage new plan formation and may cause the curtailment of plan benefits to all plan participants, not just the benefits of highly compensated employees. If the employee benefit plan community has learned anything from the enactment of ERISA in 1974, it is that employee benefit plan legislation involves complex social policy issues which require careful and dispassionate consideration by Members of Congress. The introduction of an employee benefit reform bill such as the Pension Equity Tax Act of 1982, under the pressures of the current budgetary crisis, is hardly the appropriate atmosphere for the consideration of such a far-reaching piece of legislation.

Although the five life insurance companies have not had sufficient time to carefully consider the long-term effects of HR 6410, their preliminary reactions to the bill are:

Reducing the maximum benefit levels under qualified retirement plans will create an incentive for employers to reduce benefit levels to all employees and not just the benefit levels of highly compensated employees.

Substantial amendments in existing plan documents and summary plan description and additional filings with the Federal agencies will be required as a result of this legislation. Employers, and particularly small employers, are extremely concerned about the high cost of administration associated with conforming their plans to new legislation and new regulation. These changes have been all too frequent since 1974. The administrative cost of conforming to the changes in HR 6410 will in itself discourage new plan formation. Congress recognized this administrative problem when it enacted the simplified employee pension plan legislation as a part of the Revenue Act of 1978. Consideration should be given to the administrative cost of complying with this Bill. We believe the cost of compliance will have a disproportionate negative effect on small employers.

There is much merit in the concept of eliminating differential treatment between various types of similar employee benefit plans. Unfortunately, the consistent approach of HR 6410 is to cut back benefit levels and to broaden the application of restrictive requirements to the legally more-favored type of plan. The five life insurance companies would prefer an approach which would eliminate differences between similar types of plans by raising the benefit levels of the less favored plans and eliminating restrictions in favor of simpler and more flexible plan design. Uniformity between plans is a salutary goal, but should not be considered outside of the context of comprehensive pension reform legislation.

In the last several years, Congress has repeatedly created new incentives for plan formation in order to encourage the voluntary expansion of pension coverage and to encourage additional investment capital. HR 6410 would appear to abandon the consistent approach of Congress in favor of a more restrictive policy. We are concerned that the adoption of this approach will cause a decline in the coverage of employees in qualified retirement plans and will diminish the amount of funds available for capital investment.

Changes in the integration rules for Social Security should be deferred until remedial legislation for Social Security has been enacted.

Accordingly, the five life insurance companies believe that the best interests of plans, plan participants, and national retirement policy is not well served by pension reform legislation which addresses a few issues in isolation.

Sincerely,

KENNETH G. MEUSER.

CONTINENTAL RESOURCES CO.,
Winter Park, Fla., June 1, 1982.

Mr. JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

DEAR MR. SALMON: From the information available at this writing, it is obvious that H.R. 6410 is a politically-inspired response to Congress' failure to assure the financial viability of Social Security.

All thinking persons know that the problem lies with Social Security and that the solution must be found in that area. It is entirely irresponsible to, as an alternative, attack the system of private pensions and benefit plans which industry has developed in this Country.

I will appreciate your registering these views in all arenas with which you are connected.

Yours very truly,

C. E. FROST,
Director of Insurance.

DAHLGREN & DAUENHAUER, P.S.,
Seattle, Wash., June 4, 1982.

Representative DAN ROSTENKOWSKI,
Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI: I am writing to you as a tax lawyer and pension consultant in Seattle, Washington to express the strong opposition of myself, our law firm and our clients to H.R. 6410, introduced in the House Ways and Means Committee on May 19 by Congressman Charles B. Rangel. Hearings on H.R. 6410 are scheduled in Committee for June 8 and 9. This letter is in supplement of a telegram mailed to your office on June 2 opposing H.R. 6410.

Our office represents in excess of 500 private pension plans of closely held business and professional corporations in the Northwest states of Washington, Oregon, Alaska and Montana, which plans cover in excess of 2,500 employees. I am also a vice-president and director of the Small Business Council of America, Inc. (SBCA), an organization formed to protect the interests of small businessmen in Congress. Morton Harris of Columbus, Georgia and Converse Murdock of Wilmington, Delaware will present testimony on behalf of SBCA at the Hearing.

I recently returned from a trip to Washington, D.C. on May 14-17, during which time I visited the Senate offices of our Northwest states in addition to attending the spring meeting of the Section of Taxation of the American Bar Association. Based on my recent visit, I understand the tremendous pressure on Congress to find a solution to the current budget deficits, and it may be that the private pension area is a potential source of additional revenue which will assist in reducing the deficits. However, it seems that there are at least three major reasons why it would be unwise for Congress to adopt pension legislation at this time in a hasty manner, particularly in the form presented by the H.R. 6410.

BACKGROUND OF PENSION LAW

First, the current pension laws have been carefully constructed by the Tax and Labor Committees of Congress over a period of years and have created a stability in the private pension field which has not been achieved in the tax laws in general. The thrust of the pension law has been to encourage private pension plans and in spite of excessive burdens of compliance, large and small corporate employers have adopted pension plans which benefit all covered employees in a comparable and non-discriminatory manner. This resulting broad coverage of employees is required by ERISA, the major Pension Reform Act passed by Congress in 1974, for a pension plan to enjoy tax-qualified status. H.R. 6410 would reverse this favorable trend and will most certainly result in the curtailment of private pension plans with a resulting reduction in the retirement benefits of all covered employees. In this regard, I believe H.R. 6410 is clearly a "pension reform" Act rather than a revenue Act as it is being presented by its proponents in connection with the budget problems facing Congress. As a "pension reform" Act, the Department of Labor and Labor Committees of Congress should be consulted before any attempt is made to ramrod H.R. 6410 through Congress. Based on a recent meeting with a ranking member of the Department of Labor, I am unaware of any plan by the Administration to in any way alter or reduce the existing contribution levels of private pension plans.

SOCIAL SECURITY PROBLEMS

Second, with the Social Security System in deep financial trouble, employees are taking a keen interest in their private pension plans and are placing similar importance on their pension benefits as they do on general job security. The presence of a vital private pension system in this country has helped private industry attract and retain qualified workers who can help their employers compete in today's international markets. This conclusion is particularly true of small business which often has difficulty attracting qualified personnel. To alter the private pension system at this time with Social Security near bankruptcy, I believe, will create great unrest and cause unneeded concern and worry among employees in an already struggling work force. Employees covered under private pension plans will not understand why Congress has chosen such an inopportune time to alter and reduce their private pension benefits. In this regard, there is no question but that H.R. 6410, as proposed, will reduce existing contribution levels for all employees covered by private pensions.

DISCRIMINATORY ASPECTS OF H.R. 6410

Third, as an incorporated professional, I strongly object to the blatant discrimination of HR 6410 in singling out personal service and professional corporations for special and unusually harsh treatment. Since the late 1960's, the highest courts in the country have consistently and unanimously decreed that professionals shall have the same right to incorporate as all other businesses. Previous attempts in Congress to single out professional corporations for discriminatory treatment were defeated by substantial margins. In 1969 a Senate Bill similar to HR 6410 was defeated by a vote of 65 to 25. In 1973, in pre-ERISA discussions, another similar Senate Bill was defeated by a vote of 89 to 2. More recently, neither the report of the President's Commission on Pensions, nor S 1561 or HR 4330 (ERISA Simplification Bills) make any reference to creating a second and substandard class of corporate pension plans. There is no substantive difference between a professional income, business income, or any other income derived from personal efforts, and yet HR 6410 would require that they be treated differently for pension plans. If anything, professionals who do not have access to stock option plans are more dependent upon their private pension plan for financial security. Should Congress decide that pension reform is needed, the proposed changes should effect all corporations regardless of size or form, with no one group singled out for special treatment. To so obviously discriminate against a prticular group under the heading of "Tax Equity Act of 1982" would result in a grave miscarriage of justice by Congress.

ENCOURAGE PRIVATE PENSIONS

Based on my more than 20 years of experience as a tax lawyer and pension consultant, I believe that the private pension system should be encouraged, rather than curtailed as HR 6410 proposes. Contributions made to private pension plans are directed into traditional investment areas. A major portion of such contributions are deposited in savings institutions and invested in stock and bond markets. The majority of our clients pension assets are, at this time, invested in savings certificates and U.S. Treasury bonds. Pension funds invested in this manner are a positive factor to the national economy and should be encouraged. These pension assets so invested can be contrasted with income that is directed into tax shelter investments because the income tax structure has become too burdensome. It is my experience as a tax lawyer that such tax shelter investments are not productive to the economy in general, are generally not good investments, and should be discouraged. The existing private pension contribution levels offer a strong investment alternative to the tax shelter area. As previously noted, under ERISA, any contributions by corporate employers into private pension plans benefit all covered employees in a comparable and non-discriminatory manner. I believe this positive and productive investment alternate should be continued and encouraged.

I am also enclosing a one page letter written by an associate of mine David N. Larson, to Congressman Al Swift. This letter accurately summarizes our objection to HR 6410.

CONCLUSION

Your early and strong opposition to HR 6410 is encouraged and will be appreciated. I am furnishing Congressman Rangle with a copy of this letter so that he will be aware of the strong objection by incorporated professionals to the discriminatory aspects of HR 6410.

Yours very truly,

DONALD C. DAHLGREN.

[Attachment]

LARSON LAND & TIMBER CO.,
June 1, 1982.

Representative AL SWIFT,
U.S. House of Representatives,
Washington, D.C.

DEAR REPRESENTATIVE SWIFT: I am writing to express my alarm at HR 6410 introduced by Rep. Rangel in the Ways and Means Committee and to strongly urge you to vote against it as well as work for its defeat.

I was formerly a CPA in Edmonds who for 20 years stressed to my small business and professional clients the necessity for providing for their future financial security—primarily through pension plan contributions—and that it would be unwise as well as un-American to expect the Government to take care of them. The current concerns about Social Security have helped validate this position.

For many years the thrusts of the Federal Income Tax laws have been—quite properly—designed to provide increasing incentives for funding private pension plans. HR 6410 not only would reverse this desirable trend, but more distressingly, singles out closely held business and professional corporations for particularly harsh treatment.

HR 6410 is masquerading as a revenue bill. If budgetary needs require that limits (hopefully temporary) be placed on pension plan contributions, let them be across the board to include large corporation and government plans.

Unfortunately, HR 6410 does not stop with revenue items. For example, it proposes to prohibit participant loans to key employees. This would be very harmful to small businesses. In an era of tight money such as we have now, participant loans from pension plans are often the only debt financing available to small businessmen and women.

Retirement programs must often be projected up to 40 years into the future. To be effective they cannot be vulnerable to short-term economic swings and political whims. We now have Federal pension plan laws that we can live with. Please vote to keep them that way.

Yours very truly,

DAVID M. LARSON.

DAVIS, ARNEIL, DORSEY, KIGHT & PARLETTE,
Wenatchee, Wash., June 2, 1982.

COMMITTEE ON WAYS AND MEANS,
Longworth House Office Building,
Washington, D.C.

GENTLEMEN: It is my understanding there is proposed legislation before Congress which will significantly restrict the pension and profit sharing plans of closely-held corporations. I am very disturbed with this, particularly if it singles out small plans for special treatment. It would seem the title of the bill "Pension Equity Tax Act of 1982" is inappropriate if small plans are discriminated against.

As a small business person, I and my employees are largely dependent upon our abilities to save sufficient money out of current earnings to have a comfortable retirement without having to fully rely on the social security system. Although no current tax is paid on sums in the plans, this will most certainly be paid at a later date on larger accumulations.

As you know, there were major changes in the pension laws in 1974 under ERISA. Further changes, particularly those consistent with H.R. 6410 will not only frustrate my retirement plans and those of my employees, they will subject me to additional costs and paper work associated with compliance with the changes. I have already been subjected to substantial expense and inconvenience in connection with complying with the ERISA mandates, regulations and rulings.

This legislation represents a serious blow to the ongoing viability of my and my employee's retirement plans. I urge you to do everything in your power to discourage any further changes in existing pension law, and not support H.R. 6410.

Very truly yours,

JAMES ARNEIL.

DERAND CORP.,
Arlington, Va., June 16, 1982.

JOHN J. SALMON,
Chief Counsel, Committee On Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON, Our country's per capita income is one of the highest ever known to mankind; yet, of every one hundred of our citizens who reach the age of sixty-five, ninety-five are broke. Of every one hundred who reach their "golden years," only two are financially independent, twenty-three must continue to work, and seventy-five are dependent on friends, relatives, or charity.

With these facts in mind, it seems incredible to me that the Committee on Ways and Means is even considering HR 6410. With the current status of the social security system, why on God's green earth is tax legislation being proposed that will make it more difficult for the risk-takers in our society, the entrepreneurs, to provide for an adequate retirement funded with the profits that are a result of the fruits of their labor?

Finally, these attacks on qualified plans of closely-held businesses involve blatant discrimination. Why should an employee who also has a substantial equity in his own business be treated any differently than an officer in a large, publicly-held corporation with greater income and greater pension expectations simply because this latter "highly paid and benefitted" employee has a very small interest in the stock of the employer.

I vigorously oppose HR 6410 and hope that is is thoroughly and rightfully defeated.

Sincerely,

G. HUNT MITCHELL,
Financial Planner.

JUNE 3, 1982.

JOHN J. SALMON, Esq.,
Chief Counsel, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I've just reviewed a copy of the proposed legislation introduced by Mr. Rangel (D-NY) and scheduled for a hearing before the Committee on Ways and Means on June 8, 1982.

As a private citizen insured under a qualified Corporate Pension Plan and as Manager of Employee Benefits responsible for the Corporation's health, welfare and pension programs, I am disturbed by the proposed legislation.

Mr. Rangel indicates two objectives of the bill:

1. Provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax subsidized pension and statutory fringe benefit plans.
2. Reduce excessive high tax limits on tax-free accumulation under Corporate Pension Plans.

After reading the proposed legislation and comparing it to the stated objectives, the bill inhibits the growth of private plans and further reduces the expected benefits of future retirees.

It further limits the tax deductions of Corporations to establish new plans or even revise existing plans.

The Social Security program as presently subsidized is not a cure-all in providing benefits to retirees. Therefore, organizations, whether they be for profit or nonprofit, should be able, if they can, to provide for pensions to reward their employees for their years of service.

By limiting integration rules and utilizing a safe harbor rule based on salary limits, you will defeat the primary purpose of the private pension plan.

The proposed legislation also would extend the Keogh Plan rules with respect to loans to assist employees under Corporate Plans. Under current defined benefit rules, this is a prohibited transaction and should be continued. ERISA was established to prevent abuses to the pension system. If the legislation was passed, pension funds would be depleted and assets would be unavailable to provide benefits for the lower paid individuals.

In effect, we could have additional plan terminations and an increase in guarantees by the PBGC which is already running at a high deficit. Ultimately, the proposed PBBC rate of $6.00 would rise substantially. Question—How long can the government expect existing plans to continue to fund terminated ones through the PBGC?

The proposed legislation also caps the estate tax exclusion for annuities paid to a beneficiary under retirement programs. If an individual has worked for his benefits, why should his estate be penalized?

In all, the proposed legislation:

1. Places additional administrative and cost burdens on the private sector.
2. Inhibits growth of pension plans.
3. Places limits on benefits for higher paid individuals.
4. Creates a situation with respect to loans to help employees that could financially disrupt existing pension funds.

The proposed legislation does not provide the equity intended and opens the system for further abuses.

If the House and Senate want to establish controls and limit benefits, they should start right in their own house with respect to their own pensions and deductible expenses.

You may include this as part of the record.

Very truly yours,

STEPHEN G. DEUTSCH, CLU.

STATEMENT OF CAROL W. TRENCHER, FELIX B. LAUGHLIN, AND STANLEY SMILACK OF DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD

These comments, submitted on behalf of interested corporate clients, relate to certain provisions of H.R. 6410, the proposed Pension Equity Act of 1982, introduced May 19, 1982 by Congressman Rangel.

OVERVIEW

The major objectives of H.R. 6410 are "to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans" and "to reduce the excessively high limits on tax-free accumulations under corporate pension plans." Remarks of Congressman Rangel, Cong. Rec. May 19, 1982, H. 2353. In fact, it is very unlikely that the enactment of the bill in its present form would promote comprehensive inclusion of employees in qualified plans. Moreover, to the extent there are perceived abuses in the amounts permitted to accumulate tax-free under the present tax-qualified pension plan rules, such abuses could be dealt with more effectively by legislation whch is more selective in approach than H.R. 6410. The revenue estimates for H.R. 6410 that have been released by Treasury indicate a very small amount of revenue would be raised by the bill in 1983 and 1984. The costs of plan changes to comply with the bill's provision would be high, and most plans would require new determination letters, placing additional burdens on Treasury and plan administrators alike.

SPECIFIC COMMENTS

1. *The current dollar limits on pension benefits and contributions should not be reduced.*—The $75,000 limit on annual pensions and the $25,000 limit on contributions were considered appropriate by the Congress in 1974 when ERISA was enacted.

"While any specific dollar limit on the amount of benefits under qualified plans is necessarily a matter of judgment, your committee believes that the annual limitation of $75,000 at age 55 or later achieves a reasonable balance in view of the considerations involved.

* * * * * * *

"Because of the vital importance of maintaining the real value of retirement benefits, the bill instructs the Secretary . . ., through regulations, to make annual adjustments in the allowable limits to take account of increases in the cost of living." Rep. of the Committee on Ways and Means, H.R. Rep. No. 93-779, 93rd Cong., 2nd Sess. 36-37.

These ERISA limits, as fairly adjusted for increases in the cost of living during intervening years, are still appropriate and should not be reduced.

Treasury in its recent testimony on H.R. 6410 has indicated that, because of the provisions of the Economic Recovery Tax Act of 1981 permitting individual retirement accounts, it is proper to reduce the dollar limits for defined benefit and defined contribution plans. It is difficult to understand how permitting a $2,000 annual IRA deduction ($2,250 in the case of a spousal IRA) justifies a reduction of more than $15,000 in the dollar limit on annual tax deductible contributions to defined contribution plans and an even greater reduction in the dollar limit on annual benefits under a defined benefit pension plan.

Treasury notes that reduction of the limits would make it easier to raise the level of deductible contributions to plans benefiting self-employed individuals, thereby facilitating "parity" between corporate and noncorporate plans. As the Congress and Treasury are aware, the long-standing objective of parity has been to raise the pension levels for self-employed individuals to those provided for corporate employees. This objective does not require reducing corporate limits; noncorporate limits should be increased instead.

2. *Cost of living adjustments in dollar limits should not be eliminated.*—It would be speculation to predict what a $90,000 annual normal retirement pension will be worth many years from now in today's dollars. But a 25 or even a 45 year old employee may reasonably be skeptical about whether the real value of this projected annuity will be substantially maintained until he or she reaches 65.

"Most employee pensions do not provide full inflation protection. . . .[A]n inflation rate of 5 percent cuts a benefit by 40 percent in 10 years. At 10 percent, inflation reduces the value of a benefit by 60 percent in 10 years. While most pension plans have provided retirees with some post retirement increases in the last several years, the average adjustment has been much lower than inflation." Coming of Age: Toward a National Retirement Income Policy, President's Commission on Pension Policy, p. 40.

Moreover, even cost of living adjustments to the maximum dollar limits in private plans provide, in effect, only partial protection against the post retirement effects of inflation since private pension plans do not typically adjust the pension amount payable after retirement.

This may be contrasted with the treatment of federal pension benefits.

"Unlike their private sector and state and local sector counterparts, federal employees receive pension benefits that are fully indexed to the CPI. . . ." *Id.*

Continued use of an index based on consumer prices (CPI) is appropriate. This index is used in large numbers of union contracts and represents a known standard. The use of another index may have a substantial detrimental impact on many contracts.

Regardless of the index used, annual adjustments in the dollar limits on benefits and contributions permit the accumulation of funds in a more rational fashion than would be the case if larger adjustments were adopted by legislative action taken only sporadically over longer intervals. Congress is aware of the desirability of providing automatic adjustments reflecting changes in the cost of living, having indexed income tax rate schedules in the Economic Recovery Tax Act of 1981.

3. *Reducing the 1.4 limit for combined retirement benefits and contributions to 1 would be unfair and unworkable.*—The language of H.R. 6410 contains a number of technical errors and presents several cases of what must be unintended results. For example, the bill's definition of the "defined contribution fraction" appears flawed. Under Internal Revenue Code ("IRC") section 415(e)(3), as proposed to be amended by the bill, this fraction would be the greater of (i) the ratio of annual additions for any year to the maximum additions ($30,000) for the year or (ii) the average of such ratios for all years (with a special rule for years ending before 1984). Suppose an employee age 64 is entitled to an annual pension of $20,000 and, just before the employee retires, the employer establishes a profit sharing plan under which a single $30,000 contribution is made on the employee's behalf. Under the bill, it appears that the employee's pension would be completely forfeited because the employee's defined contribution fraction (his "annual fraction") would be "1" in the year of retirement. This result must not have been intended.

Efforts to reduce the 1.4 limit where both a pension benefit and fixed contribution benefit are available would retroactively penalize decisions made in reliance on current law. For example, if an employee made voluntary contributions in excess of 6 percent of compensation (as permitted by current law, within certain limits), his "cumulative defined contribution fraction" would increase. These contributions may have had no adverse impact on the employee's projected pension benefits when made, but provisions of the bill may now operate, unfairly, to reduce the employee's ultimate pension on account of these voluntary contributions.

Another example of how the bill could retroactively penalize decisions made in reliance on current law is that, under current law, an employer may have chosen to apply the 1.4 limit either by limiting contributions to a profit sharing plan to 40 percent of the maximum while maintaining a pension plan providing 100 percent of the applicable pension maximum or by using up the full defined contribution limit while restricting the defined beneft limit. The bill provides for adjustment of the pre-1984 "defined contribution fraction" to reflect the current 1.4 limit: however, there is no comparable adjustment for the defined benefit fraction to reflect the fact that a portion of the defined benefit accrued under the current 1.4 limit. As a result, employees of an employer that provided benefits principally through a defined benefit plan would be unfairly disadvantaged as compared with employees whose employer provided benefits principally through a defined contribution plan. Problems of this type cannot easily be avoided. Any efforts to correct the flaws described above would result in even greater levels of complexity.

Moreover, any reduction of the 1.4 limit would frustrate the policies that presumably led to the adoption of the 1.4 limit under ERISA where an employer maintains both a defined benefit and defined contribution plan for its employees. The allowance of a higher limit in these situations encourages employers to cover their employees by both types of plans, rather than maintaining only one type. This provides a more balanced retirement income program for the employees since the two types of plans complement each other. This is particularly true since the adoption of ERISA, which includes pension insurance provisions that increase the level of commitment imposed on an employer in adopting a defined benefit plan.

In addition to the difficulties mentioned above, a reduction of the 1.4 limit may well provide an impetus for the establishment of selective non-qualified excess benefits plans, contrary to one of the major objectives of the bill to provide incentives for the comprehensive inclusion of employees in tax-qualified plans. If the bill is enacted, employers would, as a practical matter, have to adopt such excess benefits plans in order to provide the level of benefits to which the employer is currently committed, and may well decide to reduce rank and file benefits in proportion to the reduction in limits. An excess benefits plan must be unfunded and would not be subject to non-discrimination requirements. The proliferation of such plans would be undesirable.

4. *The fiscal goal in imposing an actuarial reduction in benefits on early retirement would be better served by a different approach.*—H.R. 6410 would require an actuarial reduction in the maximum benefits from age 65 (instead of age 55 under current law). The principal rationale offered by Treasury for actuarially reducing benefit limits on early retirement (no rationale is provided in the remarks on introduction of H.R. 6410) is the prevention of the "artificial acceleration of deductions" for pension plan contributions. A substantial and unfair reduction in pension benefit limits from present levels in tax-qualified plans would result from such change. The perceived abuse of artificial acceleration of deductions could be prevented by a less intrusive approach, such as a reduction in the dollar limits whenever the employee has fewer than a specified number of years of plan participation (such as 10 or 20 years).[1]

Moreover, the absence of an actuarial reduction in the maximum benefits where payments commence between age 55 and age 65 is balanced, under current law, by the fact that no actuarial increase in the maximum benefits is provided where payments commence after age 65. Imposition of an actuarial reduction where benefits begin before age 65, without any change in the present rule where benefits begin after attainment of age 65, would produce an illogical asymmetry. If there is to be a reduction for retirement before age 65, there should be additional benefits available for those continuing to work after that age.

5. *Interaction of proposed changes on limits may cause unjustifiable reductions.*—The interaction of the proposals to reduce the dollar limits on pension benefits and contributions, to eliminate cost of living adjustments, to reduce the 1.4 limit for combined retirement benefits and contributions to 1, and to require actuarial reductions in benefits for early retirement may operate together to cause very substantial

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[1] Under current law, the limits are reduced if the employee has fewer than 10 years of service with the employer.

reductions in benefits for some employees, inconsistent with their present reasonable expectations. Consider, for example, an employee who after 1983 would (but for the bill) earn a pension of $120,000 which would be unreduced for early retirement at age 55 and who would also participate in a defined contribution plan under which the employer makes a 10 percent contribution each year. Assuming that his employer would choose to eliminate the defined contribution plan to comply with the required reduction of the 1.4 rate to 1, the employee would be forced to forego all future benefits under the defined contribution plan and would receive a pension of approximately $31,500 (35 percent of $90,000[2]) at age 55. In the absence of H.R. 6410, the employee's annual pension on retirement at age 55 would have been $120,000. Thus, the employee would not only lose all future benefits under the defined contribution plan, but also his pension would be reduced by almost 75 percent and could not be increased to reflect changes in the cost of living during his lifetime. Such a drastic reduction in agreed upon benefits is simply not justified.

6. *Medical benefits for retirees should not reduce pension benefits.*—The bill would reduce the maximum benefit levels to take into account the annual value of post retirement medical benefits. There is no satisfactory reason why medical benefits provided to retired persons should be taken into account for pension limit purposes. In fact, it is desirable to have private employers participate in the insurance of retired employees because such participation helps relieve pressure on publicly financed medical care. Further, as Treasury has noted in its testimony, there are difficulties in computing the annual value of post retirement medical benefits.

7. *The treatment of any loan from a section 401(k) plan as a distribution would adversely affect retirement savings.*—Cash and deferred plans under IRC section 401(k) cannot, without disqualification under IRC section 401(k)(2)(B), make "distributions" to employees before age 59½, except in certain limited cases of hardship. The bill would treat a loan from a cash and deferred plan as a "distribution," thus effectively making all loans impermissible from such a qualified plan. If it is intended to prohibit loans from such plans, language explicitly so providing should be used.

In any case, it should be noted that a younger employee would be reluctant to defer receipt of contributions if the amount deferred would be effectively inaccessible until age 59½. This would undermine the intent of IRC section 401(k) to promote retirement savings. Any abuses associated with loans in the IRC section 401(k) context should be remedied by an approach that deals only with the abuses rather than eliminating the possibility of such loans altogether.

8. *Revision of the way in which private pension plans integrate with Social Security would involve substantial administrative costs; the 1:2:1 "safe harbor" is inappropriate.*—The bill would substantially revise the current rules permitting private defined benefit pension plans to take into account the employer-provided portion of Social Security. The bill would apply these changes only to persons who become participants after 1983 (presumably because it is believed to be unfair to impose such drastic changes with respect to benefits for current participants). This would probably require most pension plans to maintain two benefit formulas, one for post-1983 participants to conform to the new rules and one for pre-1984 participants to conform to the old rules. The increased administrative cost would be substantial, and the bifurcated benefit structure would be hard to explain to employees.

The bill would include a safe harbor for plans which integrate on a "step rate" basis providing benefits for compensation (i) up to $30,000, (ii) from $30,000 to $60,000 and (iii) over $60,000 at a ratio of 1:2:1, respectively. Given that these new integration rules only apply to ppost-1983 participants, it is unclear how this safe harbor would work for a pension plan that is integrated currently at a step rate that does not satisfy this test. Take, for example, a plan which now provides a pension for each year of service equal to .5 percent of compensation up to the Social Security wage base plus 1.5 percent of compensation over the wage base. It is not clear whether the bill would permit this system to continue for all pre-1984 participants if post-1983 participants receive a 1:2:1 benefit of .5 percent of compensation up to $30,000, 1 percent of compensation between $30,000 and $60,000 and .5 percent of compensation over $60,000. It would seem unlikely that this would be permissible because it would allow overall lower benefits for post-1983 participants who would tend to be much lower compensated initially. If, on the other hand, pre-1984 participants must be taken into account to conform with the 1:2:1 test, it is very unlikely that any plan would adopt this "safe harbor."

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[2] Based on a 7 percent interest rate assumption and the 1984 Unisex Pension Mortality Table, a lifetime pension beginning at age 65 should be reduced by 65 percent to provide an actuarially equivalent lifetime pension beginning at age 55.

9. *The exclusion applicable to statutory fringe benefits should not be eliminated where coverage is provided for a substantial group.*—Premiums paid by an employer with respect to group term life insurance (for coverage up to $50,000) and health and accident plans are generally excluded from the gross income of covered employees. Such coverage should not be subjected to additional federal regulation in the form of nondiscrimination rules without some showing of abuse. Currently, such coverage is typically provided by employers to substantial groups of employees. If employees where nevertheless denied the exclusion unless specific nondiscrimination rules were met, many employers would choose to drop the coverage in order to avoid the costs associated with coverage increases as well as the costs of administrative compliance. This result is not desirable and should be avoided.

CONCLUSION

H.R. 6410 would change dramatically a number of the rules of ERISA. As a result of the bill's flaws, some of which are discussed above, if the bill were enacted as presently drafted, there would be no broadening, and probably a narrowing, of the employee groups covered by tax-qualified retirement plans. Further, for certain employees the reduction in benefits available under tax-qualified plans would be drastic. It seems likely that the general response of employers to the bill would involve reductions in coverage and benefit levels. Moreover, the revenue impact of the bill would be small, particularly when compared to the costs which would be borne by employers sponsoring qualified plans who would be forced to amend their plans to comply with the new provisions of H.R. 6410.

STATEMENT OF EASTMAN KODAK CO.

Eastman Kodak Company is a 102-year-old company having major manufacturing facilities located in seven states with worldwide headquarters and our largest facility located in Rochester, New York. Kodak employs over 91,000 people in the United States. Those employees are generally long-term, career-oriented people, as witnessed by the fact that about half of our current employees have over 10 years of service and the average term of employment upon retirement is 31 years. As a result of the efforts of these dedicated employees, Kodak had a positive balance of payments last year of $1.3 billion.

Kodak maintains for virtually all of its employees in the United States a defined benefit pension plan as well as a cash-deferred, profit sharing plan qualified under Code section 401(k). The objective of these plans, along with health care and life insurance programs, is to create an environment whereby retiring career employees will be able to maintain preretirement standards of living through a combination of Kodak provided plans, government programs, and personal savings. We believe that meeting this objective is good for our people, good for Kodak, and consistent with current economic policy as evidenced by ERTA.

Several provisions of the proposed Pension Equity Tax Act of 1982, H.R. 6410, would seriously undermine this objective. We would like to focus on three parts of that bill:

1. *Loans to plan participants.*—Section 3 of the bill would treat loans from 401(k) plans as distributions subject to income taxation. Loan provisions of such plans have encouraged participation by people whose limited economic resources necessitate borrowing in certain circumstances. Consequenlty, Sec. 3 will discourage lower and middle paid people from future participation in plans and would violate an implied trust with current participants.

2. *Integration with social security.*—Section 4 of the bill would impose future restrictions on Social Security integration limits, which would change the relative level of benefits that may be provided under private pension plans for various groups of employees. The terms of the bill are so broadly drawn that it is not possible to accurately calculate its effect. But clearly it would significantly threaten the maintenance of long established relationships between the pre and postretirement incomes of individuals.

3. *Overall limits on contributions and benefits.*—Section 2 of the bill would make drastic reductions in maximum benefits and contributions allowed for individuals under qualified plans and would eliminate the annual cost-of-living adjustments to these limits. This would seriously dilute the protection provided by sound funding practices, particularly for a large and growing number of plan participants with long service.

LOANS TO PLAN PARTICIPANTS

Kodak's cash-deferred, profit-sharing plan enables employees to make a once-a-year election to defer all or a part of their annual profit sharing bonus, which typically amounts to 12–13 percent of current yearly pay after an employee has five or more years of service. Once deferred, the money must remain in the plan, except in extreme hardship situations, until the plan participant leaves the company or attains age 59½. The plan, thereby, enables all levels of our employees to accumulate a fund to provide a supplement to Kodak and government retirement benefits.

Understandably, many employees, especially younger, lower-paid people with uncertain financial futures, children to educate in 10 to 15 years, changing family situations, and the like, are very reluctant to "lock up" this money for the many years until retirement. What encourage a large number of these people to participate is the loan provision, whereby a participant may borrow up to 50 percent of the value of his or her account at current prevailing interest rates.

The loan must be repaid within three years. Furthermore, an employee with an outstanding loan may not participate in the deferred paln. Thus, participants are provided with some temporary access to funds in their accounts in cases of need less urgent than extreme hardship, but are encouraged not to be too casual about seeking such loans. Around 75 percent of the borrowers are in the lower two-thirds earnings group.

H.R. 6410 will essentially eliminate the loan provision for many thousands of participants by requiring that such loans be treated as taxable distributions. A prospective borrower needing $1,000 would have to borrow at least $1,400 to allow for taxes and then, of course, repay the entire $1,400 plus interest. A great financial hardship would be imposed on those individuals forced to raise funds through this most inefficient method because no alternatives exist for them.

Furthermore, many current participants elected to participate in the plan with the belief that they would be able to borrow from the plan in the future if necessary. It would be a breach of faith to deny these people access to loans by changing the rules under which they elected to participate. Many of these elections were made as long as twenty years ago.

If Congress wishes to limit further the potential for abuses of loan provisions in 401(k) plans, it should consider establishing maximum borrowing levels, minimum interest rates, maximum repayment periods and, perhaps, restrictions in borrowing by highly paid participants. In any case, different requirements should not be imposed on 401(k) plans than on other defferred profit-sharing arrangements. The proposed provision is counterproductive, unwieldy, discriminatory against 401(k) plans and most onerous to lower paid participants.

INTEGRATION WITH SOCIAL SECURITY

As indicated earlier, an important objective in the retirement area is to help an employee replace pre-retirement earnings through a combination of company benefits, Social Security benefits, and personal savings. For lower paid people, we do not assume the availability of personal resources and try to accomplish the entire objective through company and Social Security benefits. To do this, we have a retirement plan which generates for low and moderately paid career employees, an annuity which results in total after-tax income of over 100 percent of preretirement, after tax income. For example, an employee earning $18,000 a year and retiring at age 65 after 35 years of service will have a Kodak annuity of around 39 percent of his or her final pay. If the retiree is single, this benefit combined with Social Security will result in "take home" pay of 101 percent of the preretirement level. If there is a spouse, the after tax replacement can be over 115 percent of the preretirement level. See Example 1 attached.

On the other hand, we expect higher paid people to have personal savings to use in retirement. Thus, for an employee earning $135,000 a year, for example, we plan on Social Security and retirement plan benefits replacing only 70 percent of preretirement, after tax income. To accomplish even this lower level replacement, the company benefit must, of course, be a higher percentage of pay than for a lower paid person. The reason for this is simply that Social Security benefits are a relatively less significant portion of the higher paid person's total retirement income. In our example, the higher paid employee is provided with a Kodak annuity representing a somewhat higher percentage of pay, as compared with the lower paid person. However, the actual combined after-tax retirement income for the lower paid person is 101 percent of salary versus only 70 percent for the higher paid person.

Under current integration rules, differentials in company-paid benefits are permitted and broadly used in the private pension system. If the allowable range of these differentials should be narrowed by H.R. 6410, our plan would have to be revised to pay inappropriately high benefits to lower paid people or to pay inappropriately small benefits to higher paid people, or both. We believe that even currently permissible differentials are too low, and urge the Congress to not exacerbate the problems.

This seemingly modest proposal in H.R. 6410 has far reaching implications for both Social Security and private pension systems. Thus, it should not be treated as a simple revenue raising measure, but should be very carefully considered by a more appropriate body such as the President's Social Security Commission.

OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

Finally, a general comment on limitations on benefits from qualified plans ("Section 415 limits"). Currently, only a few highly paid people are effected by these limits, and like most companies we pay the differential from an unqualified plan. This arrangement is manageable because explanations and administrative requirements are limited by the few people involved.

H.R. 6410 proposes new limitations on benefits. It is difficult to understand the logic of these new restrictions. American economic practice requires and tax law allows, as a tax deductible business expense, wide variations in pay levels. Not allowing similar differences in funding for a proportionately higher retirement benefit seems inappropriate.

Unlike the present limits, the proposed changes could impact thousands of Kodak people and could result in limits on benefits to even the lowest paid employees. For employees earning, say $10 an hour, it will be of significant concern to learn that a portion of their future benefits will now have to come from a nonqualified, unfunded plan, because their benefits exceeded tax deductible limits (see attached Example 2).

Because the proposed limits are not related to service, they are especially punitive with respect to career employees, whose pension benefits are much more likely to reach maximum levels than shorter service people. Kodak has long prided itself on its success in retaining good employees for a full career of service and is disturbed by the penalties these limits would impose on those employees.

CONCLUSION

These three areas of H.R. 6410, as well as provisions not discussed, need to be very carefully considered. If enacted as proposed this bill would impact the wrong people, require breaking promises to employees, create severe administrative and communications problems, and would conflict with sound, logical benefits objectives.

EXAMPLE [illegible]

Table 1 shows before and after tax replacement ratios from Kodak and Social Security plans for employees retiring at five different grade levels.

Employee 1, for example, earns an annual salary of $18,015. If he is single, his after tax, "take home" pay would be around $13,673 per year, after Federal, New York State and FICA taxes are paid. If he retires at age 65 with 35 years of service, the combination of Kodak and Social Security pension benefits will yield an after tax income of $13,819, or 101.1 percent of after tax income before retirement. If this employee has a spouse the same age, his after tax pay in retirement would be 115.8 percent of his after tax pay as an active employee.

As pay increases for Employees 2, 3, 4, and 5, the Kodak benefit as a percent of pay increases slightly, but the Social Security benefit drops sharply. The result is a decreasing replacement of pay on both a before and after tax basis. The comparison to be made here is the percentage of preretirement earnings replaced by the combined after tax income from Social Security and Kodak's retirement plan.

TABLE 1.—RETIREMENT BENEFITS: KODAK AND SOCIAL SECURITY

Employee	Final salary	Before tax benefit as percent of salary			After-tax net income					
					Single			Married		
		Kodak	SS	Total	Preretiree	Retiree	Percent difference	Preretiree	Retiree	Percent difference
1	$18,015	39.1	39.7	78.8	$13,673	$13,819	101.1	$14,694	$17,019	115.8
2	27,290	40.1	32.1	72.2	18,907	18,661	98.7	20,613	23,614	114.6
3	36,245	41.4	24.1	65.5	23,659	21,916	92.6	26,105	27,074	103.7
4	53,100	43.9	16.5	60.4	31,931	27,919	87.4	35,684	33,713	94.5
5	135,000	47.1	6.5	53.6	68,786	48,570	70.6	63,735	57,424	90.1

July 1, 1982 retirement. Age 65 with 35 years' service. N.Y. resident. If married, spouse is same age.

EXAMPLE 2

Table 2 shows how the proposed changes to Section 415 limits would affect two employees.

Employee A is a higher paid employee earning $175,000 who has had 9 percent pay increase over the past 5 years. $1,300 of his $37,300 retirement benefit would have to be paid from the unqualified plan. While this is still a relatively high pay level, an employee who today is paid $31,000 will be at that level in 10 years.

Employee B represents a serious problem. It shows that an employee at the lower end of the pay scale can be affected by the proposed limits. This employee, because of transferring from shift work to day work or from an incentive to straight time job or for any other reason, had flat earnings during the last 2 years of employment. Under the proposal, even the benefits payable to this employee will exceed the limit. It will be a significant concern to this employee that a portion of his expected retirement benefit must now be paid from a nonqualified, unfunded plan.

Under the present limits, Employee B would have all benefits provided from a qualified, funded plan.

TABLE 2.—IMPACT OF PROPOSED SECTION 415 LIMITS

	Employee	
	A	B
Salary history:		
1982 earnings	$75,000	$20,000
1981 earnings	$68,800	$20,000
1980 earnings	$63,100	$18,300
1979 earnings	$57,900	$16,800
1978 earnings	$53,100	$15,400
Service at retirement (years)	40	40
Defined contribution (profit-sharing) plan benefit for 1982	$9,750	$2,800
Defined benefit (pension) plan; annual benefit if January 1, 1983 retirement	$37,300	$9,280
Defined contribution fraction [1]	0.52	0.56
Defined benefit fraction [2]	0.48	0.44
Annual benefit from qualified pension plan [3]	$36,000	$8,800
Annual benefit from unqualified pension plan	$1,300	$480
Total	$37,300	$9,280

[1] Under H.R. 6410, the maximum addition to a defined contribution (profit-sharing) plan is the lesser of $30,000 or 25 percent of current salary. Assuming full participation in the profit-sharing plan, then the defined contribution fraction for say Employee B would be $2,800 divided by 25 percent ($20,000) equals 0.56.

[2] Under H.R. 6410, if say Employee B participates in both a defined contribution and a benefit plan, that employee would receive an aggregate benefit from the qualified plans that is reduced from 140 percent to only 100 percent of the separate limits. Thus, Employee B will have a defined benefit fraction of (1—defined contribution fraction) e.g., 1—0.56=0.44.

[3] Under H.R. 6410, the maximum benefit Employee B can receive from the qualified pension plan is not the $9,280 currently allowed. The bill will reduce the benefit to the defined contribution fraction multiplied by the lesser of $90,000 or current salary. Thus, Employee B would receive only $8,800 from a qualified pension plan.

STATEMENT OF BERRIEN C. EATON, EATON, LAZARUS & DODGE, LTD., PHOENIX, ARIZ.

My name is Berrien C. Eaton, and I am a shareholder-director-officer-employee of a small incorporated law firm, Eaton, Lazarus & Dodge, Ltd., 5050 North 40th. St., Phoenix, AZ 85018 (Telephone 602-955-6700). I am filing this statement for the printed record on behalf of the firm, myself, and the numerous small professional and business corporations which we represent. (An outline seems superfluous for such a brief presentation.)

The firm does not have a "qualified" pension or profit-sharing plan, and neither do many of our aforesaid clients. Only one member of the firm has ever participated in a corporate qualified plan—and I am not the one. Nevertheless we unanimously and strenuously oppose H.R. 6410, primarily its discriminatory provisions.

For many years I have been extremely active in both A.B.A. and state tax section activities; have lectured and written extensively and widely on the subjects of deferred compensation and PC's, especially for the American Law Institute—American Bar Association Joint Committee (generally called A.L.I.-A.B.A.); and am known primarily as the author of a six-volume treatise on professional corporations published by Matthew Bender & Co. in 1970 and updated semi-annually. I also was one of the national originators of the PC concept and formed the first one in Michigan in early 1962. So I have a thorough knowledge of their background and technical aspects, although I am a "moderate" in using and espousing them. I view them as simply another variety of personal service corporation.

The greatest single impetus to PC's (professional corporations) was the invidious disparity between the tax treatment of incorporated and unincorporated businesses epitomized by H.R. 10 (the Keogh legislation). Also, even as the H.R. 10 limits were gradually increased over the years, there nevertheless remained within H.R. 10 itself an indefensible distinction between large and small businesses. For example, a large law partnership (where there are no 10 percent owners) can today have a reasonably workable H.R. 10 plan, but a small partnership is classed as having "owner-employees" (10 percent of more owners) and thus saddled with restrictions which render H.R. 10 generally undesirable. Large firms have enough advantages over small firms already (in hiring, etc.) without blessing them with this additional advantage. PC's are the only way in which small firms can achieve tax equality.

Almost everywhere you look in the Internal Revenue Code, there are an increasing number of provisions either favoring big business or discriminating against small business. Examples include medical reimbursement plans, stock options, equipment leasing, investment credits, etc.

Discrimination is odious, no matter whom the victim. It simply must stop not only on grounds of tax morality and fairness but also for practical reasons. If small business continues to feel that it is the helpless victim of politically motivated tax discrimination, and if there is no way to escape, you will simply drive business into so-called "shelters" or even underground and encourage more fraud. Also, when you make qualified plans unattractive for the owners, you in effect deprive the rank and file of their benefits.

Congress over the years has created a mess—a virtually bankrupt Social Security system—a monstrous debt that destroys the economy—an incomprehensible tax code—and an accelerating rate of tax legislation which makes it almost impossible for small business to keep pace, to pay the legal and accounting costs, or to plan with any certitude. ERISA was a veritable earthquake of change, and there have been major tremors almost annually thereafter. Don't you realize what this does to business costs and business planning?

Corporate qualified plans (large and small) are one of the few mechanisms that are generally feasible and good for the country. They encourage orderly saving, are major sources of capital, take some of the burden off Social Security, and really cost nothing. The income tax is deferred, but it is eventually paid, and the money is meanwhile "on the table" and used for good purposes. Take these plans away or make them unpalatable, and much of these visible funds will simply disappear. They may never be taxed.

On the other hand, I have always advocated parity—even "parity down" if that is all the country can afford—but I would only settle for parity down on the following basis:

1. The budget is absolutely and permanently balanced, and inroads are made on the debt (possibly as proposed by Mr. Steadman).
2. The so-called "untouchables" are cut in the process, including defense, welfare, and Social Security.
3. Congress stops feathering its own nest and abides by the same pension and fringe benefit rules as everybody else.

I also agree wholeheartedly with the more scholarly presentation submitted by the Kansas Bar Association. I wish that I had time to be as thorough.

What you apparently think you are doing is "soaking the rich." Actually, however, you are hitting the middle class, especially those individuals who believe in and practice the work ethic—the most productive members of society. And even if you were really soaking the rich, it won't work. Remember what happened in the 1940's and 1950's where tax rates on the top brackets hit upwards of 70 percent. Big business salaries and fringes simply jumped from one or two hundred thousand dollars into the millions; and once they got up there, they never came down. Who paid for it? The general public.

ECOFF TRUCKING, INC.,
Greenfield, Ind., July 7, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR SIR: This is a written statement for the printed record of the hearing on H.R. 6410, the Pension Equity Tax Act of 1982. As required, five copies of this statement are enclosed.

The statement is filed by: Sarah P. Shaw, Benefits Manager, Ecoff Trucking, Inc., R.R. 10, Box 100A, Greenfield, IN 46140, 317/894-2500.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. The lowering of maximum benefit and contribution limits and elimination of the automatic cost-of-living escalator will have a severe adverse effect on lower-paid workers. Reduction of the maximum benefit if payment is made prior to age 65, in a defined benefit plan, will discourage early retirement and have an adverse effect on the unemployed and underemployed.
2. Elimination of plan loans to key employees will have the effect of eliminating loan provisions altogether and will cause severe economic hardship to many American workers.
3. The change in defined benefit plan integration to allow an offset only with respect to Social Security benefits paid for by the employer who maintains the plan should not apply to plan participants who have adequate service to receive full benefits.
4. There is no rational basis for singling out employees in certain industries to receive reduced retirement benefits.
5. We support the concept that non-discriminatory rules should apply in statutory fringe benefit programs.
6. No new legislation is needed in the estate tax area.

It is my general opinion, and that of my firm, that this proposed legislation is an effort to completely undermine the private pension system at a time when our increasing aging population is in dire need of the means to be self-sufficient. Each year, the ratio of active workers to those who are dependent on them for inter-generational monetary transfers gets smaller. Each year the inability of the public Social Security system to anticipate inflation becomes more obvious. This legislation would introduce the worst elements of the Social Security system into the private retirement system, would virtually negate much of the Employee Retirement Income Security Act of 1974, and would work its greatest hardship on lower-paid workers who can least afford reductions in retirement benefits. My specific objections and suggestions are outlined below:

(1) H.R. 6410, Section 2: Lowering the maximum permissible benefits and contributions would have its most drastic effect on lower-paid workers. Plan formulas would be adopted (or revised) to provide the highest paid participants with the lower benefit or contribution and, in the process, benefits or contributions for lower-paid workers, who can least afford reduced pensions, would be cut. For example, if a company whose owner earns $300,000 per year were to establish a defined contribution plan under the present law, a contribution formula of 15 percent of compensation would provide the owner-participant with a near-maximum contribution of $45,000. If that same company were to establish a plan under the terms of the new bill, a contribution formula of 10 percent of compensation would provide the owner-participant with the maximum benefit and it is likely that the selected formula would not exceed that percentage. Thus, the contribution for a worker who earns $10,000 per year would be $1,000 annually rather than the $1,500 annual contribution which could be available under the present law. There would be a similar result in a de-

fined benefit plan. In virtually every instance where a reduced maximum would cause reductions in benefits or contributions for the highly-paid, there will be resultant reductions in benefits for lower-paid workers if the bill is enacted. The lower-paid workers will feel the effect of the reductions more severly than will the higher-paid workers, who will have other capital (more capital, in the case of owner-participants, because of savings in retirement plan contributions) available for retirement savings, if the bill is enacted.

The proposal to cut back the maximum benefit under a defined benefit plan if payment is made before age 65 (55 under present law) is contrary to public policy in that it discourages early retirement. This is, perhaps, the most damaging proposal in the entire bill. By requiring a cutback in the maximum benefit (in addition to the actuarial cutbacks already required under present law, in integrated plans) the terms of the bill would make it impossible, in many cases, for higher-paid workers to retire before age 65 at an income level even near to what they need to maintain their current life styles. The absolutely certain, and immediate, effect of enactment of this provision would be reduced employment at all levels as higher-paid workers must remain employed. Without question, minority workers would pay the entire cost of this provisions as the older, higher-paid, traditionally white male executive is forced to remain on the job. Fewer opportunities for advancement at all levels would open up for the traditionally unemployed and underemployed minorities. At a time when unemployment is at near-depression levels, it is truly unthinkable to even propose legislation of this type.

Removal of automatic cost-of-living increases from the maximum benefit and contribution sections of the law would result, again, in lower contributions and benefits at all levels. This proposal is particularly bad because private sector plans would be saddled with the most pronounced weakness in the public sector Social Security system, which is the inability to cope with spiraling inflation.

(2) H.R. 6410, Section 3: This bill would effectively eliminate loans to certain key employees and, in the process, to all employees. It is unlikely that many plans would contain any loan provisions if the company owners and officers were not entitled to receive them (without being taxed on the loan amounts). It seems inconceivable to prohibit workers from borrowing against what is, in many instances, their largest asset, without incurring tax liability. I find it incredible that the proposed effective date for this provision is May 19, 1982. This could literally cause financial ruin to plan participants throughout the nation, who are now borrowing money in accordance with the terms of the law as it is now written and who are totally unaware of this bill.

In this section, the bill shows a total insensitivity to the needs of workers at all levels to use their savings to finance current emergency needs. This comes at a time when it is especially difficult to obtain commercial financing. Under present law, each participant loan must be reported to the government annually. If it is believed that there are abuses in the use of plan loan provisions, then I suggest stricter enforcement of the present law. The guidelines for loans to participants are clearly set forth in E.R.I.S.A. and a mechanism for monitoring loan activity has been established as a part of the annual reporting requirements. Surely proper enforcement is a better solution to any participant loan problems than abolition of what is a most essential part of any savings system, for many American workers.

(3) H.R. 6410, Section 4: This section appears to be contradictory to the rest of the bill in that reduced Social Security offsets will cause increased costs and, thus, increased tax deductions. More importantly, the proposed reduced offset should only apply with respect to plan participants who receive reduced pensions because of short service. In other words, the full present offset should be allowed with respect to any participant who has enough service with his or her present employer to receive a full benefit under that employer's plan.

(4) H.R. 6410, Sections 5 and 6: Because recent legislation, already enacted, has eliminated the means for discriminatory abuse in the professional corporation retirement plan area, it is our belief that there is no rational basis for choosing the employees in certain industries and occupations to receive less favorable tax treatment than others. Also, this section makes no provision for protection of already accrued benefits.

(5) H.R. 6410, Section 7: We generally support the principle of prohibiting discrimination with respect to statutory fringe benefits.

(6) H.R. 6410, Section 8: Present law, generally, denies an estate tax exclusion to those who receive favorable income tax treatment with respect to death payouts from qualified plans. It is our belief that no further legislation is necessary in this area.

In summary, we believe that H.R. 6410, if enacted, would make a mockery of all efforts during the past decade to create retirement plan equity. The bill was poorly conceived and its precepts show total disregard for the rights and problems of American workers. The bill has little in the way of safeguards for already accrued rights and its enactment will cause billions of dollars of administrative expense to companies who can ill afford such costs. Beyond all of this, the enactment of this bill would certainly trigger a reduction in the number of workers who are guaranteed retirement safety, as plans are terminated or not implemented because of the provisions contained in the bill.

Very truly yours,

SARAH P. SHAW, *Benefits Manager.*

STATEMENT OF LUIS GRANADOS, REPRESENTING THE EMPLOYEE STOCK OWNERSHIP ASSOCIATION

I am Luis Granados, counsel to The Employee Stock Ownership Association, which is the national trade association of companies with Employee Stock Ownership Plans (ESOPs). The purpose of my testimony is to alert this Committee to a problem that would be caused by Section 2(c) of H.R. 6410 as presently drafted, and to suggest a way of amending this section that would avoid this problem without frustrating the principal intent of the bill.

Section 2(c) of the bill amends Internal Revenue Code Section 415(e) by eliminating what is commonly known as the "1.4 rule". Under this rule, a participant is both a defined benefit plan and a defined contribution plan may receive annual additions to his accounts in an aggregate amount 1.4 times greater than if he were a participant in one type of plan only. Section 2(c) of the bill would change this to a "1.0" rule, so that no participant would be allowed extra annual additions by virtue of being in both types of plans.

The apparent purpose of this provision is to treat all plan participants equally by eliminating a benefit enjoyed by participants in multiple plans. Without commenting on whether this is a desirable end in general, it is our position that there is at least one class of cases in which eliminating this benefit would produce undesirable results. That class is the leveraged ESOP buyout of a company, a financial procedure often used by employees in an effort to preserve their jobs when the company might otherwise close.

Leveraged ESOP buyouts tend to involve large amounts of money, and especially in the early years of the plan require very large contributions and annual additions to accounts in order to service the ESOP's debt. The amounts involved can be so large that contribution and annual addition limits can become a serious limiting factor on whether or not the deal can be consummated. Unless the ESOP is permitted to receive enough from the employer each year to satisfy its obligation to the lender, there will be no deal. Congress recognized this problem in the Economic Recovery Tax Act of 1981, when it substantially raised the deduction and annual addition limitations for contributions to a leveraged ESOP made for the purpose of repaying a stock acquisition loan.

Section 2(c), as presently constituted, would be a complete reversal of what Congress tried to do last year. Instead of making it easier for employees to purchase their company, it would make it harder for them to do so. Whenever any type of pension plan is present, employees may be forced into a Hobson's choice: either give up all or part of the pension plan, or forget about the ESOP and lose their jobs.

This provision puts the squeeze on employees in two ways. Not only does it reduce the 1.4 rule to a 1.0 rule, but Section 2(c)(2)(A) raises the defined contribution fraction to the greater of the current year's fraction or the accumulated fraction over the participant's experience with the plan. This will mean that a leveraged ESOP that has been in existence for a number of years making only modest contributions will lose the benefit of that self-restraint should a situation arise in which a major financing for the benefit of employees becomes necessary.

To avoid throwing the baby out with the bathwater, what is needed is a carefully drawn exception to Section 2(c) to give employees the flexibility they need in a leveraged buyout situation. One straightforward way to do this would simply be to exclude amounts contributed to a leveraged ESOP for purposes of repaying a stock acquisition loan from the computation of the defined contribution fraction.

Such an approach would recognize the unique dual nature of the leveraged ESOP. The leveraged ESOP is both an employee benefit plan and an established technique of corporate finance. Both the Congress and the Internal Revenue Service have recognized this unique dual nature of the leveraged ESOP on several occasions. (E.g., Section 803(h) of the Tax Reform Act of 1976 and Revenue Ruling 79-122). Thus, it is not correct to treat the leveraged ESOP as just another employee benefit plan, because it is not. It is an employee benefit plan that is also a technique of corporate finance, and it is imperative that in drafting legislation which affects it Congress take both of these aspects into account.

Sometimes the greatest discrimination lies in treating different things alike. To say that the leveraged ESOP should be treated no differently from any other employee benefit plan is to ignore its recognized nature as a technique of corporate finance. To limit the amounts that may be financed through it for the benefit of employee-owners dollar for dollar by the amounts used to provide retirement security for those employees is to limit its effectiveness as a tool of corporate finance for employees—or to force them to give up their retirement security. By exempting amounts contributed that are used strictly for the purpose of repaying amounts that have been financed, Congress should reaffirm the dual nature of the leveraged ESOP.

We submit that the dual nature of the leveraged ESOP is not a quirk or a loophole in the law, but is in fact a very healthy option available to America's free enterprise system. The leveraged ESOP technique of corporate finance is the only such technique that must operate (and does operate) primarily for the benefit of average working people. There are many techniques available for providing credit for the purpose of purchasing capital to people who are already wealthy. But the leveraged ESOP is the only technique for providing access to capital credit to people who are not already wealthy.

The most dramatic example of working people's need for capital credit arises in the threatened plant shutdown situation, in which the only way workers can save their jobs is to purchase their company. They quickly discover that the only way to purchase a company is with access to capital credit; and the only practical avenue of access to capital credit is the leveraged ESOP.

As a result, we read about case after case of workers using a leveraged ESOP to buy their company and save their jobs. Last fall, it was General Motors employees purchasing a roller bearing plant in Clark, New Jersey. Now it is 10,000 steel workers trying to purchase their plant in Weirton, West Virginia. Tomorrow it will be another group in another place, willing to assume the risks and the rewards of ownership in our free enterprise system in order to keep the production lines rolling.

Study after study shows that in most these cases, there is a substantial improvement in productivity once the workers realize that it is their company and that it suddenly makes a big difference to their own pocketbooks how well that company fares. But if the 1.4 rule is changed without making provision for the special case of the leveraged ESOP, many of these already difficult deals may needlessly force workers to give up their pensions to save their jobs, or may even become completely impossible.

HOUSE OF REPRESENTATIVES,
Washington, D.C., June 7, 1982.

Hon. CHARLES B. RANGEL,
House Office Building.

DEAR CHARLIE: As you know, I have long been concerned with the future of our national retirement system and I am continuously exploring new approaches to strengthen the private pension system in order that it be better able to meet the steadily-increasing retirement income needs of this country. In this regard, I would like to call to your attention the comprehensive provisions in my legislation, H.R. 4330 and H.R. 4334, which was jointly referred to the Ways and Means and the Education and Labor Committees. In addition, I was interested to see that your Committee has scheduled hearings on H.R. 6410, the "Pension Equity Tax Act of 1982," which you recently introduced.

Based on a brief review of H.R. 6410, it is apparent that the bill proposes some major changes in the structure of private pension plans, and that the bill could affect the continuation of existing plans and the growth of new plans in different ways. It has been my experience that any proposals along these lines require thorough study in order that the potential long-term, as well as short-term, effects on the very diverse employee benefit plans community may be fully analyzed. In view of the difficult budgetary and revenue adjustment decisions that now confront us, and the limited time available in this Congress, I do not believe there is adequate time to give all of the changes of the magnitude contained in H.R. 6410 the consideration they deserve. A few specific observations on certain provisions of the bill may help explain why I believe action on H.R. 6410 should be deferred beyond the 97th Congress.

Among other things, H.R. 6410 proposes extremely major revisions to the long-standing rules for coordinating private pension plan benefits and Social Security benefits for purposes of the tax law non-discrimination requirements (commonly referred to as Social Security "integration"). I believe that the concept of "integration" is fundamental to the continued growth of the private pension system and is a key element in the development of a rational national retirement income policy. While changes in integration may be appropriate, the task of improving the current rules in this area is a particularly complex and difficult one. Further, in view of the current study which the National Commission on Social Security Reform is conducting of possible changes to the System—and the potential impact that the adoption of any changes in Social Security could have on private pension plans—piecemeal action in this area could easily prove to be counter-productive to the development of appropriate national retirement policy goals. Once the Social Security question has been settled, a study effort would be in order to consider changes to the integration rules, including a simplification of the rules as I have proposed in H.R. 4330.

H.R. 6410 also would make substantial changes in the limitations on qualified plan benefits and contributions (IRC Sec. 415) that we imposed in 1974 in connection with the Employee Retirement Income Security Act. I have always felt that the substantial tax incentives which we provide to encourage employers to voluntarily establish retirement plans for their employees are essential to the continued maintenance and growth of the private pension system. This is not to say that we should not re-examine these incentives to ensure that they are accomplishing their objectives. However, it is very important that the long-term impact of any proposed changes in this area be carefully analyzed and understood.

While I have not yet made a detailed study of the proposed changes to Section 415 contained in H.R. 6410, it is important to note that such significant changes could well have an adverse effect on a much broader spectrum of the covered workforce than may be apparent at first glance. For example, since employer plan benefit formulas are generally required to provide employees with uniform benefits as a percentage of their compensation, reductions in the maximum benefits allowable under a plan may frequently have the effect of reducing the benefits provided to rank-and-file employees. In addition, it would be important to examine whether the proposed 100 per cent limitation that would be applied (instead of the current 140 per cent limitation) when employers have two separate plans (e.g., both pension and profit-sharing) could have an adverse effect on (and possibly cause the termination of) the plan that is particularly beneficial and attractive to the younger workers, including minority groups and women, covered by the plan. Moreover, in view of the continued pressure of inflation on employee wages and benefit levels, the long-term implications of these proposals on the potential retirement benefits of individuals who are currently earning only modest wages should be carefully explored.

I am also concerned about the potential adverse effect on current plan funding levels that these changes could invite. As you may know, the current provisions under Title IV of ERISA are deficient and present an unacceptable level of risk to the maintenance of the single employer insurance program by the Pension Benefit Guaranty Corporation. Provisions in H.R. 4330 would encourage faster funding, reduce unfunded liabilities, and restore to the single employer insurance program a measure of financial stability. It is my sincere hope that your Committee will give as much attention to the long-term effects of plan underfunding as to the short-term revenue effects of the proposed changes under H.R. 6410.

In summary, I very much share your interest in making our private pension system more equitable and a more effective complement to Social Security and private savings. However, these goals must be achieved in ways that will encourage—rather than discourage—a healthy and expanding private pension system. If past experience is any indication, the proper reconciliation of these complex policy goals cannot be accomplished hurriedly, on a piecemeal basis, or at a time when other critical budgetary and revenue considerations necessarily demand so much of our attention.

Sincerely yours,

JOHN N. ERLENBORN.

FARMERS GROUP, INC.,
EMPLOYEES' PROFIT SHARING SAVINGS PLAN TRUST,
Los Angeles, Calif., June 17, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI: Farmers Group, Inc., urges the Committee on Ways and Means to set this Bill aside and hold any further action until proper study can be made by the business industry and other interested parties. We feel that the Bill addresses problems that have not yet been fully analyzed, and that need a great deal more study.

On the surface, we feel that the Bill, if passed, would create severe inequities. In addition, there are some other key areas that cause great concern, which are:

1. The Bill will discourage private retirement plans.
2. Many existing plans would require extensive revisions. These revisions would be costly, and would impose a greater administrative burden for future years. This would cause a reduction in business profits.
3. "Maximum" amounts would no longer be adjusted for inflation. This is unrealistic and unfair to the participants of both defined contribution and defined benefit plans.

In addition, it appears that participants of certain defined contribution plans would be the victims of double taxation. Many of these plans provide for annual distributions, and some individuals would be taxed when the contribution is made, and also when periodic distributions of monies are released.

We have kept our comments brief, however, we urge you to give due consideration so that all interested parties can give proper study and make any appropriate recommendations.

JOHN R. CHESEBROUGH,
Director of Compensation and Benefits.

DOUGLAS M. FARR & CO., INC.,
La Crescenta, Calif., June 10, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: I am president of the above named firm which is engaged in the design, installation, and administration of pension and profit sharing plans. I currently have about seventy clients with a total of 100 plus retirement plans. This represents approximately seven to eight hundred participants in all of the plans which I administer.

First, I would like to state for the record that H.R. 6410 is a piece of legislation which has not been thought out by its sponsors. I make this statement for the following reasons:

(1) The Bill, if passed in its present form would severely cripple firms such as mine which are engaged in the administration of retirement plans. At least one third of my clients are professional corporations who would have no reason to continue their retirement programs under this legislation. I have no idea as to how I would make up this loss of revenue.

(2) It is private pension administrative firms such as mine whose need is becoming greater and greater with the severe funding problems experienced by the Social Security System. The technical expertise to install, service and administer private pension plans must be promoted. This legislation would discourage talented people from entering the field.

(3) By limiting the amount of contributions which professional corporations can make to their retirement plans, the Bill creates a disincentive to set up any retirement plan at all, thus either reducing or eliminating any pension for rank and file employees.

(4) Money which is deposited in retirement plans is used much more efficiently in the private sector than if taken into the government coffers.

(5) The intention of H.R. 6410 is to reduce the amount of funds a professional person can contribute to his own retirement plan and thereby increase the tax revenue of the Federal Government. The overriding objection I have to this piece of hastily drafted legislation is that it intends to "go after" wealthy professionals, rather than look for ways to reduce government spending.

By copies of this letter to my elected representatives I urge them to oppose this piece of discriminatory legislation.

I enclose five copies of this letter for the House Ways and Means Committee hearing on June 18th, 1982.

Very truly yours,

DOUGLAS M. FARR.

G. M. FELDMAN & CO.,
June 15, 1982.

JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

DEAR MR. SALMON: On May 19, 1982, Representative Charles Rangel introduced the Pension Equity Tax Act of 1982 (HR-6410). In light of the financial troubles of the Social Security Administration and the enormous need for capital to rebuild the United States manufacturing complex to compete in the international marketplace, it is totally counter-productive to reduce the amount of money which can be contributed to the private retirement plan sector which is a major source of investment capital.

Therefore, I adamantly oppose any amendment to the current tax law, including HR-6410, which would alter the current tax statuses relating to retirement plans.

Very truly yours,

GERALD M. FELDMAN.

FINANCIAL EXECUTIVES INSTITUTE,
New York, N.Y., June 18, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR MR. ROSTENKOWSKI: The Committee on Taxation of Financial Executives Institute [1] submits the following comments for the record of the hearings conducted on June 9, 1982 on Representative Rangel's proposal, Pension Equity Tax Act, H.R. 6410. We are particularly disturbed that this bill could be included among the various Budget proposals and its impact inadequately determined.

We are concerned that private pensions and other employer sponsored benefit plans could incur severe damage from this proposal. In addition, we feel this bill is counterproductive to the needs of our economy, the encouragement of thrift and capital accumulation.

We feel H.R. 6410 would.

1. Weaken the private retirement system and adversely impact long term savings.
2. Reduce benefits for significant numbers of lower and middle income employees.
3. Increase the pressure on a currently weak Social Security System.
4. Impose restrictions on private plans not applicable to government plans.
5. Misdirect capital necessary to long-term investment to amending current plans as well as significantly impacting administrative costs, through a complex Social Security private plan integration system.
6. Not improve revenues sufficiently to justify the administrative disruption that would occur at IRS and in the private sector.
7. Contradict the intent of ERISA, since it would substitute unfunded benefits for funded benefits.

We cannot and do not imply that differences do not exist in many benefits areas. We do strongly urge that H.R. 6410 be removed from consideration during current budget debates and be held for subsequent analysis and hearings. Only in that light, we believe, can Congressman Rangel's desire to provide the broadest possible employee base for tax-subsidized pension and benefit plans be accurately and adequately studied and remedies found for what we feel would be its potential adverse impact on our economic recovery, inflation and reduction in unemployment.

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[1] Financial Executives Institute is the professional association of 12,000 senior financial and administrative officers of over 6,000 organizations, large and small, throughout the United States and Canada.

Respectfully submitted,

Donald K. Frick,
Chairman, Committee on Taxation.

First National Bank & Trust Co. of Lincoln,
Lincoln, Nebr., June 10, 1982.

Mr. John Salmon,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

Dear Mr. Salmon: First National Bank & Trust Company of Lincoln, Lincoln, Nebraska, acts as trustee for a number of retirement plans. In this capacity, we are in close contact with our corporate customers and we frequently hear their concerns about costly plan amendments and paperwork required to maintain a qualified retirement plan.

The purpose of this letter is to enter our formal statement of dissatisfaction into public record regarding proposed House Bill H.R. 6410.

We are concerned that any pension legislation of this magnitude could hinder, rather than encourage, the growth of the private pension system. Pension plan sponsors have already been subjected to numerous changes and additional paperwork in the last few years.

Social security and private savings have been experiencing severe difficulties—social security because of changing demographics and the current economic environment, and private savings because of the impact of inflation on the ability of Americans to save.

President Carter and now President Reagan have established commissions to study the problems of social security. Congress has recently passed legislation (1978 Revenue Act and 1981 Economic Recovery Tax Act) to encourage individual thrift. Why should we now place a substantial restriction on retirement income?

We question whether the government can realize any significant amount of indirect revenues by making these changes.

It is our understanding that a stated purpose of the proposed legislation is to realize additional government revenues. The primary impact on employer contributions in plans of major corporations would be lower contributions for a handful of top executives (who are affected by lower benefit limitations). This will not generate significant revenue dollars for the U.S. government.

The other changes affecting corporate plans would require substantial corporate outlay in terms of design changes, new documentation, and explanations to employees, but would not necessarily decrease the overall level of tax-deductible employer contributions to these plans. In fact, for those employers who can afford to preserve their present plan formulas, the more restrictive social security integration rules would increase employer cost (and thereby decrease government revenues).

We question whether any changes should be made in social security integration rules before larger issues concerning the social security system have been addressed.

With the expectation that Congress will soon have to make significant changes in the social security system, it is premature to consider revisions in the manner in which private pension plans are permitted to coordinate with the public system. We urge Congress to address these issues in their proper and orderly sequence.

We are concerned that attempts to limit loan privileges from plans utilizing Section 401(k) of the Code will defeat a portion of Congress' original intention of establishing such plans (provided for as recently as the Revenue Act of 1978).

Among the important justifications for Section 401(k) is the broad national goal of encouraging individual thrift and deferring income until retirement. The extent to which this goal is achieved is important from a national prespective: the development of individual capital accumulation accounts should help ultimately to relieve pressure both on social security and on private pensions (especially relieving pressure to index such plans).

Based on our experience, we believe that the more a capital accumulation plan restricts accessibility of participant money, the less the eligible participants will utilize the plan for optional employee deposits.

To tax the proceeds of loans as income will have the simple negative effect of discouraging plan participation (especially when rules already exist requiring the orderly repayment of such loans).

Even Congressman Rangel's own goals in introducing the legislation would be frustrated if certain provisions of H.R. 6410 were enacted. The bill is intended to bring about broader coverage in the classes of employees in pension and fringe benefit plans. As noted above, the legislation would have a direct and adverse impact on many of the rank-and-file employees Mr. Rangel is seeking to protect. In addition to the direct effect on these employees, the reduction in employer tax incentives is likely to discourage employers from establishing, continuing or improving plans.

Before enacting legislation which would have such major repercussions on the private pension system, the bill's potential impact should be studied far more comprehensively than it has been to date. We would be willing to provide the House Ways and Means committee with available data from our plans to assist in such an effort.

Very truly yours,

James K. Suhr,
Senior Vice President.

Analysis of H.R. 6410, "Pension Equity Act of 1982", Prepared by the Tax Section of the Florida Bar

INTRODUCTION

On May 19, 1982, HR 6410, the "Pension Equity Tax Act of 1982" (PETA) was introduced to the Ways and Means Committee of the House of Representatives. Hearings were scheduled for the Bill June 8, 1982, unusually soon after the introduction of the Bill. Because hearings have been scheduled so soon after the introduction of the Bill, it appears possible that a mark-up session and the final vote of the Ways and Means Committee may occur in the very near future.

A review of the proposed legislation by the Tax Section of the Florida Bar exposes numerous areas which are either inconsistent with presently existing tax policies and/or have serious technical deficiencies or would create practical problems in the administration of retirement plans or the administration of the tax system. The Tax Section of the Florida Bar feels a clear responsibility to present to the Ways and Means Committee these areas of concern. Because of the possibility of the Ways and Means Committee taking rapid action on this proposed legislation, the comments by the Tax Section are not as detailed as would ordinarily be appropriate.

POLICY PURPOSES OF ERISA

Because the proposed legislation would make substantial changes in the Employee Retirement Income Security Act of 1974—a massive and well thought-out piece of legislation in which relatively few major changes have been made since its enactment—it is essential to understand the public policy purposes behind the passage of that legislation. At the time of Congressional consideration of the Employee Retirement Income Security Act of 1974, Congress was faced with a rapidly-expanding private pension system which lacked sufficient rules and limitations to provide a structure for the provision of secure retirement benefits. Congress took note that, while certain problems existed, there was a strong need for a private retirement system to supplement the Federal system provided by the Railroad Retirement Act and the Social Security Act (see House Report 93-533, 1974-3 C.B. 211). In taking these factors into consideration, Congress' goal in enacting the Employee Retirement Income Security Act of 1974 was to provide a system of guaranteeing retirement benefits and retirement security to the maximum number of employees at the minimum cost to the employer and to encourage the expansion of the private retirement system by providing incentives to employers to provide these benefits to their employees.

In a report by the House Ways and Means Committee discussing those aspects which ERISA should accomplish, it was stated that "a fundamental aspect of present law, which the committee bill continues, is reliance on voluntary action by employers . . . for the establishment of qualified retirement plans. The committee bill also continues the approach in present law of encouraging the establishment of retirement plans. . . ." (See House Report 93-779, 1974-3, C.B. 251).

It appears clear that the enactment of the proposed legislation would substantially decrease the incentives which have in the past encouraged employers to adopt retirement plans which benefit all employees, thus undermining a basic policy consideration which shaped the enactment of ERISA. The legislative history makes it clear that, other than the establishment of maximum limitations on contributions and benefits, Congress' goal in enacting ERISA was to provide benefits to all employees, not just lower-income employees or non-professional employees. The proponents of HR 6410, however, seem to ignore this vital underpinning of ERISA by pro-

We urge Congress to assess the need for the proposed legislation more closely. If such legislation is indeed, we ask for more time to study and discuss the implications of the proposed changes. In any event, we feel strongly that the types of changes in this bill should not be the result of a hasty search for further government revenues.

Sincerely,

Linda S. Zimmerman,
Mark E. Dalka,
Trust Account Administrators,
Pension and Profit Sharing Department Trust Division.

First Chicago,
The First National Bank of Chicago,
Chicago, Ill., June 16, 1982.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: As Secretary of the Retirement Committee and Head of the Personnel Department of The First National Bank of Chicago, I am writing to express my strong opposition to H.R. 6410 and to demonstrate to you the potential impact of some of the bill's provisions. I believe that when you consider the actual repercussions of these provisions, you will agree that the bill is inconsistent with articulated national goals and even contradicts the expressed intentions of Congressman Rangel in introducing the legislation.

The First National Bank of Chicago has traditionally sought financial security for its retired employees by providing generous retirement benefits. The pension plan, which originally was established in 1899, now covers approximately 9000 employees of the Bank and its affiliates. The pension plan provides retiring employees with an annual benefit equal to 2 percent of compensation per year of service, with a maximum benefit of 70 percent of compensation. The plan also includes a subsidized spouse's benefit and unreduced benefits commencing at age 60. For employees currently over age 50 with at least 15 years of service, unreduced benefits may commence as early as age 55. In addition to the pension plan, full-time employees with three or more years of service are covered by a profit-sharing plan under which 7 percent to 15 percent of participants' compensation generally is contributed annually.

The provisions of H.R. 6410 which reduce the limitations under Section 415 of the Internal Revenue Code would potentially affect approximately 90 percent of the participants in these plans, and would require reductions in benefits in all compensation ranges. It is estimated that as many as 75 percent of our employees would be prohibited from receiving any deferred profit-sharing benefits. The major impact would result from the reduction of the combined defined contribution and defined benefit fraction from 1.4 to 1.0 and the decrease in the the limitations for benefit commencement prior to age 65. The reduction in the dollar limitations and elimination of cost-of-living adjustments would affect a smaller number of participants initially (particularly in the lower compensation ranges), but would, of course, quickly have a more widespread effect if inflationary trends continue.

It is the long-service employee in the low-to-mid compensation ranges who would be most adversely affected by the proposed changes in the benefit limitations. The projected defined benefit fraction at age 60 for a 55-year old employee earning $20,000 annually who has worked at the Bank for 30 years would typically exceed 1.0 under the Bank's pension plan. Such an employee would not only be deprived of any deferred profitsharing contribution, but would suffer an actual decrease in his or her anticipated pension benefits. There are employees who are unlikely to have accumlated significant personal savings or to be covered by non-qualified deferred compensation arragements available to executives. This would place increasing dependence on the remaining source of their retirement income, the already weakened Social Security system.

The national policy for over forty years has been to encourage the growth of private retirement savings. Employer-sponsored pensions represent an increasingly necessary supplement to Social Security as well as an important source of investment capital. The provisions of H.R. 6410 contradict articulated national retirement policy by actually discouraging employer-sponsored pension plans. With a reduction in tax incentives, many employers will need to reconsider the cost-effectiveness of providing retirement benefits.

posing restrictions be placed on personal service corporations which would not be placed on other corporations earning similar compensation from non-personal service businesses. (See discussion under the heading Extension of HR 10 Rules to Professional Service Corporations.)

MORE RECENT TAX POLICY AS EVIDENCED BY ECONOMIC RECOVERY TAX ACT OF 1981

Since the passage of ERISA, Congress has, in various tax acts, passed various relatively minor changes with respect to ERISA which have, in general, strengthened the private retirement system and permitted additional benefits to be legitimately accrued for employees. ERTA, through various measures such as permitting the use of IRA's by active participants in retirement plans, increasing the annual deduction limits on IRA's, and doubling the deduction limits for Keogh and Sub-Chapter S plans, substantially increased the incentives for funding the private retirement system. It is generally believed that this was in part an implicit recognition by Congress that the public retirement systems—primarily Social Security—did not play as large a role in the future in providing retirement and other benefit forms to employees.

In addition to specific encouragement of the private retirement system, ERTA generally lowered tax brackets and expanded the 50 percent maximum tax on personal service income to limit the maximum tax on all income to 50 percent. This appears in part to have been motivated by recognition by Congress that high-income taxpayers deserved to be treated fairly. (It is hard to argue, as some now do, that taxing income at a 50 percent rate is giving preferential treatment to high-income taxpayers.) Another reason for this change may well have been a desire by Congress to minimize the excesses of tax planning (i.e., tax shelters which have little underlying economic merit) which invariably occur when tax rates are perceived as exorbitant and/or when the tax system does not encourage taxpayers to channel money into legitimate or productive uses.

Maximum dollar limitations for defined benefit and defined contribution plans (section 2 of PETA)

Under ERISA a limitation of $25,000 was placed on the amount which can be contributed each year under the defined contribution plans which cover an employee, and a limitation of $75,000 was placed on the amount of benefits which can be accrued for an employee under a defined benefit plan. The law also included a provision for automatic increases in these amounts to keep pace with the cost of living. The House Ways and Means Committee in House Report 93-779, stated that it is of "vital importance" to the maintenance of the real value of retirement benefits, to "make annual adjustments in the allowable limits to take account of increases in the cost of living". (House Report 93-779, 1974-3 C.B. 279). This cost of living increase roughly corresponds to the cost of living increase available to recipients of Social Security. Inflation, since the passage of ERISA, has been so dramatic that these limitations are now $45,475 and $136,425, respectively. Without these provisions, the effective retirement benefits available to a higher compensated employee might well have been cut almost in half during the past eight years.

The Bill proposes limitations of $30,000 and $90,000, respectively. Initially this appears to be a limitation which would only affect the very highly compensated. However, assuming a 5 percent inflation rate, the equivalent value of these limitations ten years from now will be $18,417 and $55,252, respectively and 20 years from now will be $11,306 and $33,920, respectively.

It is easy to say that Congress could simply amend these caps from time to time, if appropriate. However, unlike Social Security which is largely funded on a current basis, a private pension plan often cannot make up in the short term the additional funding requirements for a substantial increase in benefits. In other words, if inflation has caused the true dollar value of the defined contribution plan limitation to decrease to $18,417 and the true value of the defined benefit plan limitation to decrease to $55,252, a change by Congress in the law will require the employer to make extremely large contributions over the subsequent years to catch up for the underfunding of the plan which would have occurred prior to a Congressional increase in the dollar limitations.

How would defined benefit plan limitation cutbacks (from $136,425 to $90,000) be handled for employees near retirement age or who had retired by the 1983 effective date? Would they suffer a cutback of benefits which had already been funded? If they would, would this be constitutionally permissible? If, instead, they were "grandfathered in" would this be fair to younger employees?

The 140-percent limitation (section 2 of PETA)

ERISA contains a provision which permits employees who are covered by both a defined benefit and defined contribution plan to have the combined plans provide for limitations up to 100 percent of the defined contribution plan limitation and 40 percent of the defined benefit plan limitation, or vice versa. Originally, this provision was included as a result of lobbying primarily by large employers and unions which had plans which might have exceeded the defined contribution or defined benefit plan limitations. It seems to be clearly a matter of public policy, and beyond the scope of this analysis by the Tax Section, to decide whether this 140-percent limitation was appropriate when originally passed. However, now that it has been passed, and numerous employers have developed plans which rely upon this provision, great care should be taken in repealing or modifying it. For example, sensible transition rules should be carefully drafted if the provision is reduced or eliminated. Also, if the provision is reduced or eliminated, care should be taken to reduce it as to large employers and union plans as well as smaller employer plans.

Typically, under the 1.4 (140 percent) limitation either the defined contribution or the defined benefit plan will be a much smaller part of the 1.4 than the other (i.e., a .9 defined benefit plan and a .5 defined contribution plan). Normally, only one plan is integrated with Social Security, so that benefits for lower compensated employees are proportionately better than those under the plan integrated with Social Security. Thus, as a practical matter, the elimination of a second plan because of the elimination of the 1.4 rule would hurt lower compensated employees more than higher compensated in terms of retirement income.

Limitations on loans (section 3 of PETA)

There is no inherent reason why corporate retirement plan limitations should be amended to follow H.R. 10 plan limitations. There appears to be no reason why the law should discriminate against key employees by denying them the right to borrow from their accounts in the plan when a similar right is permitted to all other employees who are participants in the plan. Congress might want to consider provisions which would limit loans to the vested amount in the participant's account. This would help assure repayment of the loan, and would also insure that higher-paid employees did not receive loans more frequently simply because of greater credit worthiness.

Also, either Congressional or regulatory guidelines as to what constitutes a "reasonable" rate of interest would be helpful. Presently there is relatively little guidance as to how a reasonable rate of interest should be determined.

Raising minimum normal retirement age to 65 (section 2 of PETA)

If, as a matter of national policy, the normal retirement age for public and private retirement plans is raised to age 65, with a corresponding reduction in benefits for retirement prior to that time, the merits of this provision in the Bill are purely a matter of public policy and beyond the scope of the Tax Section's analysis. However, if national policy is to be changed in this regard, several factors should be considered. First, many plans which provide for a normal retirement age of less than 65 are plans which have resulted from collective bargaining or are large employer plans covering primarily or exclusively non-union employees. It would be highly unfair to leave untouched the normal retirement age limitations for plans such as these—essentially covering large employers and large unions—and to change the normal retirement age for smaller employers.

If the normal retirement age is raised from 55 to 65, consideration should be given to permitting more rapid funding with a defined benefit plan. For example, suppose a defined benefit pension plan is established for an individual aged 40 who works in an occupation in which the normal retirement age typically is age 55, for example, a surgeon or an airline pilot. If funding for the individual must be based upon the assumption that he will retire at age 65 instead of age 55, the actuary will compute contributions over a 25-year period rather than a 15-year period. The effect may well be, in the case of a small employer, that the individual cannot fund plan benefits after age 55 because he is no longer working. Even if the individual's benefits would be reduced if he took them at age 55 instead of age 65, he should at least be given the right to fund those benefits and deduct them over a more rapid period. The problem of funding on a short-term basis is even more accute with, for example, professional athletes and models, whose career expectancy will typically be a maximum of ten to fifteen years.

Postretirement medical benefits (section 2 of PETA)

The inclusion of the post retirement medical benefits for purposes of determining whether there should be a reduction in the $30,000 or $90,000 limitations seems to create needless complexities. There appears to be little or no basis for saying there is abuse of this provision under present retirement plans. However, if such a provision were enacted, how would it relate to medical benefits funded under other provisions of the Internal Revenue Code, such as trusts under IRC § 501(c)(9)?

Integration with social security (section 4 of PETA)

There is no question but what social security contributions and benefits are highly discriminatory in favor of middle and particularly lower compensated individuals. Furthermore, in a closely held corporation in which the key employees also own a portion or all of the employer, these employees in effect are contributing both the employer and employee portion of Social Security. The IRS has computed the amount, depending upon the type of plan, which is permitted to be taken into account in adjusting for social security.

The underlying concept of the proposed legislation is completely the opposite of the present method of integrating Social Security. Under the proposed Bill the contributions made by the employer maintaining the retirement plan are used as the basis for determining the permissible integration under the plan. Under the present method, which was in effect long before ERISA, the benefits to be derived by an employee from Social Security are the basis for determining the integration formula. The basis concept of the existing method is that the public and private retirement systems should be blended. Also, the present system recognizes that benefits under Social Security have only a very low correlation with the amount of contributions made by an employee. In the future, as the wage level base increases, and percentage of employee compensation which must be contributed to Social Security increases, there probably will be even less correlation than now between amounts contributed and benefits realized under Social Security. Thus, the proposed legislation in effect abandons the idea of blending the public and private retirement systems.

The basic point which is overlooked by the proposed legislation is that, to a medium or higher-compensated employee, private retirement benefits have come to be thought of as helping to offset the increasing discrimination and expense which has developed with respect to the Social Security system. The question is not what Social Security contribution the employer made on behalf of the employee for the year. Rather, it is the disparity between what a middle or higher level income employee contributes to Social Security and what his anticipated benefits under Social Security will be. This is particularly important in view of the fact that Social Security, unlike private retirement systems, is funded basically on a current basis. Thus, Social Security contributions might increase markedly, say, ten or twenty years from now, but this increase could not truly be offset by any private retirement system as to employees who were near their retirement at the time the adjustments were made.

Changes in H.R. 10 plans (section 5 of PETA)

Various changes are proposed in connection with H.R. 10 plans, including an increase in the deductible limitation under defined contribution plans from $15,000 to $30,000. The Tax Section has no technical objection to this increase; however, in view of the general tendency in the Bill to limit benefits in favor of the highly-compensated, it should be noted that this provision is only of benefit to partners earning in excess of $100,000 annually.

The expansion of HR 10 limitations on owner/employees to all partners appears to be part of the compromise which was necessary in order to have the $15,000 HR 10 limitation raised to $30,000. However, the Tax Section has no objection to these provisions on technical grounds.

Extension of H.R. 10 plan rules to professional service corporations (section 5 of PETA)

The H.R. 10 plan rules would be extended to personal service corporations under the Bill. The only logic the Tax Section can see in such an extension is that it emanates from an implicit agreement among long national law firms to, in effect, equalize the retirement plan treatment under H.R. 10 plans and corporate plans for law firms, as a means of avoiding the need for large law firms to incorporate. If the H.R. 10 plan limitations should be applied to personal service corporations, why should they not be applied to all corporations?

Even assuming that applying the H.R. 10 plan limitations to personal service corporations is constitutional and appropriate in theory, the actual application would be extremely difficult. In 1980, Congress passed IRC §414(m), a provision basically designed to require that partnerships of professional corporations cover non-professional employees on a non-discriminatory basis. The definitional problems arising in connection with this provision have been staggering. The IRS implicitly has admitted that these problems exist by failing to issue proposed, temporary, or permanent regulations in connection with this provision, by recently extending for several years the deadline for final compliance with this provision, and by delaying for months private letter rulings with respect to the provision. One of the problems is that a personal service corporation, unless arbitrarily defined, is difficult to determine. For example, is a corporation which provides nurses on a temporary basis to hospitals and other health facilities a personal service corporation in the field of health? If so, how does one deal with the fact that some of these corporations are national, and have divisions which include other than employees engaged primarily in health care? What about national hospital corporations?

Athletes are among those included in professional service corporations. However, should account be taken of the fact that athletes, typically, have much shorter careers than people engaged in the health, law, engineering, architecture, etc., fields? For example, a professional boxer, even though outstanding, will almost certainly have a career of no more than ten years. If the H.R. 10 plan limitations were applied to the boxer, he would in effect be deprived of the right to have the kind of retirement plan benefits available to individuals earning far less than a boxer. Are models included or excluded from personal service corporations? If they are excluded, why should they be differentiated from athletes? If they are included, can't the same concern be expressed as with athletes, in that models, typically, have a short professional career? How should professionals be dealt with who are employed by corporations which employ other individuals? For example, why should a lawyer working in private practice be subject to H.R. 10 limitations which would not apply if he worked for a large corporation? The same question can be asked with respect to accountants, actuaries, engineers, etc.

Statutory fringe benefit plans (section 7 of PETA)

The provisions on fringe benefits appear to do little more than take a confusing area and make it even more confusing. As a practical matter, almost any smaller corporation which provides substantial fringe benefit programs under the restrictions imposed by the present law would be able to provide similar benefits under the new legislation. However, the actual technical requirements of compliance create additional problems which in many cases involving small employers will lead to frustration and to the employers simply not adopting, or discontinuing, a plan which would benefit rank and file employees. Big corporations will have no problem either (i) complying with the new laws because their larger number of employees will minimize coverage problems or (ii) providing non-statutory fringe benefit programs to extremely highly-compensated key employees and simply giving additional bonuses to cover the tax detriment of such fringe benefit programs.

Limitation on estate tax exclusion (section 8 of PETA)

Under present law if a beneficiary does not elect ten year income averaging with respect to distributions from a retirement plan, and the proceeds do not pass to the participant's estate, an estate tax exclusion will be available for the entire amount of the decedent's accrued benefits. The proposed law would impose a limitation of $500,000 on this estate tax exclusion. Under ERTA, the estate of the first to die of the husband or wife will normally pass free of estate tax to the survivor because of the 100 percent marital deduction. However, if the amount in a retirement plan is paid out in installment form (i.e., as an annuity for ten years certain) to the surviving spouse, it would probably constitute a terminable interest and not qualify for the marital deduction with respect to the first to die. Thus, this provision could have the effect of forcing, for estate tax reasons, lump sum distributions from the plan which might not be in the best interest of protecting the surviving spouse. In view of the fact that a $90,000 benefit is permitted to be accrued under H.R. 6410, it would seem that the $500,000 limitation should be increased to at least as large an amount as the lump sum value of a $90,000 per year accrued benefit at age 65.

FOGLE, SHERIDAN & ASSOCIATES,
ACTUARIES AND EMPLOYEE BENEFIT CONSULTANTS,
June 8, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington D.C.

DEAR SIR: This is a written statement for the printed record of the hearing on H.R. 6410, the Pension Equity Tax Act of 1982. As required, five copies of this statement are enclosed.

The statement is filed by John K. Sheridan, Partner, Fogle, Sheridan and Associates, 1329 W. 96th Street, Suite 110, Indianapolis, Indiana.

Summary of Comments and Recommendations:

(1) The lowering of maximum benefit and contribution limits and elimination of the automatic cost-of-living escalator will have a severe adverse effect on lower-paid workers. Reduction of the maximum benefit if payment is made prior to age 65, in a defined benefit plan, will discourage early retirement and have an adverse effect on the unemployed and underemployed.

(2) Elimination of plan loans to key employees will have the effect of eliminating loan provisions altogether and will cause severe economic hardship to many American workers.

(3) The change in defined benefit plan integration to allow an offset only with respect to Social Security benefits paid for by the employer who maintains the plan should not apply to plan participants who have adequate service to receive full benefits.

(4) There is no rational basis for singling out employees in certain industries to receive reduced retirement benefits.

(5) We support the concept that non-discriminatory rules should apply in statutory fringe benefit programs.

(6) No new legislation is needed in the estate tax area.

It is my general opinion, and that of my firm, that this proposed legislation is an effort to completely undermine the private pension system at a time when our increasing aging population is in dire need of the means to be self-sufficient. Each year the ratio of active workers to those who are dependent on them for inter-generational monetary transfers gets smaller. Each year the inability of the Public Social Security system to anticipate inflation becomes more obvious. This legislation would introduce the worst elements of the Social Security system into the private retirement system, would virtually negate much of the Employee Retirement Income Security Act of 1974, and would work its greatest hardship on lower-paid workers who can least afford reductions in retirement benefits. My specific objections and suggestions are outlined below:

(1) H.R. 6410, Section 2: Lowering the maximum permissible benefits and contributions would have its most drastic effect on lower-paid workers. Plan formulas would be adopted (or revised) to provide the highest paid participants with the lower benefit or contribution and, in the process, benefits or contributions for lower-paid workers, who can least afford reduced pensions, would be cut. For example, if a company whose owner earns $300,000 per year were to establish a defined contribution plan under the present law, a contribution formula of 15 percent of compensation would provide the owner-participant with a near-maximum contribution of $45,000. If that same company were to establish a plan under the terms of the new bill, a contribution formula of 10 percent of compensation would provide the owner-participant with the maximum benefit and it is likely that the selected formula would not exceed that percentage. Thus, the contribution for a worker who earns $10,000 per year would be $1000 annually rather than the $1500 annual contribution which could be available under present law. There would be a similar result in a defined benefit plan. In virtually every instance where a reduced maximum would cause reductions in benefits or contributions, for the highly-paid, there will be resultant reductions in benefits for lower-paid workers if the bill is enacted. The lower-paid workers will feel the effect of the reductions more severely than will the higher-paid workers, who will have other capital (more capital, in the case of owner-participants, because of savings in retirement plan contributions) available for retirement savings, if the bill is enacted.

The proposal to cut back the maximum benefit under a defined benefit plan if payment is made before age 65 (55 under present law) is contrary to public policy in that it discourages early retirement. This is, perhaps the most damaging proposal in the entire bill. By requiring a cutback in the maximum benefit (in addition to the actuarial cutbacks already required under present law, in integrated plans) the terms of the bill would make it impossible, in many cases, for higher-paid workers to retire before age 65 at an income level even near to what they need to maintain their current life styles. The absolutely certain and immediate, effect of enactment of this provision would be reduced employment at all levels as higher-paid workers must remain employed. Without question, minority workers would pay the entire cost of this provision as the older, higher-paid, traditionally white male executive is forced to remain on the job. Fewer opportunities for advancement at all levels would open up for the traditionally unemployed and underemployed minorities. At a time when unemployment is at near-depression levels, it is truly unthinkable to even propose legislation of this type.

Removal of automatic cost-of-living increases from the maximum benefit and contribution sections of the law would result, again, in lower contributions and benefits, at all levels. This proposal is particularly bad because private sector plans would be saddled with the most pronounced weakness in the public sector Social Security system, which is the inability to cope with spiraling inflation.

(2) H.R. 6410, Section 3: This bill would effectively eliminate loans to certain key employees and, in the process, to all employees. It is unlikely that many plans would contain any loan provisions if the company owners and officers were not entitled to receive them (without being taxed on the loan amounts). It seems inconceivable to prohibit workers from borrowing against what is, in many instances, their largest asset, without incurring tax liability. I find it incredible that the proposed effective date for this provision is May 19, 1982. This could literally cause financial ruin to plan participants throughout the nation, who are now borrowing money in accordance with the terms of the law as it is now written and who are totally unaware of this bill.

In this section the bill shows a total insensitivity to the needs of workers at all levels to use their savings to finance current emergency needs. This comes at a time when it is especially difficult to obtain commercial financing. Under present law, each participant loan must be reported to the government annually. If it is believed that there are abuses in the use of plan loan provisions, then I suggest stricter enforcement of the present law. The guidelines for loans to participants are clearly set forth in E.R.I.S.A. and a mechanism for monitoring loan activity has been established as a part of the annual reporting requirements. Surely, proper enforcement is a better solution to any participant loan problems than abolition of what is a most essential part of any savings system, for many American workers.

(3) H.R. 6410, Section 4: This section appears to be contradictory to the rest of the bill in that reduced Social Security offsets will cause increased costs and, thus, increased tax deductions. More importantly, the proposed reduced offset should only apply with respect to plan participants who receive reduced pensions because of short service. In other words, the full present offset should be allowed with respect to any participant who has enough service with his or her present employer to receive a full benefit under that employer's plan.

(4) H.R. 6410, Sections 5 and 6: Because recent legislation, already enacted, has eliminated the means for discriminatory abuse in the professional corporation retirement plan area, it is our belief that there is no rational basis for choosing the employees in certain industries and occupations to receive less favorable tax treatment than others. Also, this section makes no provision for protection of already accrued benefits.

(5) H.R. 6410, Section 7: We generally support the principle of prohibiting discrimination with respect to statutory fringe benefits.

(6) H.R. 6410, Section 8: Present law, generally, denies an estate tax exclusion to those who receive favorable income tax treatment with respect to death payouts from qualified plans. It is our belief that no further legislation is necessary in this area.

In summary, we believe that H.R. 6410, if enacted, would make a mockery of all efforts during the past decade to create retirement plan equity. The bill was poorly conceived and its precepts show a total disregard for the rights and problems of American workers. The bill has little in the way of safeguards for already accrued rights and its enactment will cause billions of dollars of administrative expense to companies who can ill afford such costs. Beyond all of this, the enactment of this bill would certainly trigger a reduction in the number of workers who are guaranteed retirement safety, as plans are terminated or not implemented because of the provisions contained in the bill.

Sincerely,

JOHN K. SHERIDAN.

STATEMENT OF EDWARD H. FRIEND & CO.

This letter presents the comments of Edward H. Friend & Company with regard to HR 6410, referred to as the Pension Equity Tax Act of 1982.

Edward H. Friend & Company is an actuarial consulting firm specializing in employee benefit and casualty risk consulting. Edward H. Friend & Company has a broad diversified clientele ranging from small to large employers sponsoring defined benefit, defined contribution, and health and/or welfare plans. We are intimately involved with virtually all aspects of the pension law addressed in the bill and feel highly qualified to respond to these points.

It is our opinion that HR 6410 would adversely affect a siginificant protion of the participants in qualified defined benefit and defined contribution plans and that, more often than not, the provisions will have an adverse effect on lower-paid employees. Our specific comments follow.

1. Section 2 of the bill would reduce the annual dollar benefit limitations of defined contribution and defined benefit plans, repeal the current cost-of-lving adjustment to such limits, reduce the overall limit for participants covered by both types of plans, and provide for a reduction in the annual benefit limitation for people retiring prior to age 65. These changes, taken separately and/or taken together, will have an adverse effect on a majority of plan participants.

a. We believe the reduction in the annual benefit limitations will have two major impacts:

(i) It will result in a reduction in benefit formulas for plans currently inexistence and in the establishment of lower than anticipated formulas for new plans.

The proposed benefit limitation would curtail benefits to high-paid employees. Plan formulas (under defined benefit plans) and plan contribution arrangements (under defined contribution plans) will, therefore, be revised to accommodate the limitations. Thus, the limitation will reduce benefits for the lower-paid employees as well.

(ii) It will result in an increase in the number of unfunded, excess benefit plans (i.e., top-hat plans).

Benefits lost under qualified plans due to the reduced annual benefit limitations will be supplemented for high-paid employees under "top-hat" plans or similar arrangements.

We question the validity of the dollar amounts of the limitations (i.e., the $90,000 and $30,000). On what basis were these amounts established?

We believe the adjustment to the dollar limits where medical benefits are received under a pension plan is unworkable since the value of a medical benefit is unknown until actually paid. To project the value of medical benefits could result in reduced retirement benefits without a corresponding benefit from medical usage.

b. It is detrimental to repeal the cost-of-living adjustment to the annual benefit limitations, especially in light of recent inflation. Without any adjustment, dollar limits will soon become outdated.

We recommend an automatic annual adjustment to the dollar limits as opposed to periodic, ad hoc adjustments. Automatic adjustments allow sponsors to fund increased benefits in an orderly fashion. Orderly funding is extremely important in defined benefit plans. In defined contribution plans ad hoc adjustments of increased limitations can result in inequities. For example, ad hoc adjustments may be delayed for several years and may be lost forever to participants in defined contribution plans.

c. Reducing the overall limits for participants covered under both defined benefit and defined contribution plans will result in the elimination of many "second plans" of employers. This could be detrimental because "second plans" tend not to be integrated and, therefore, are relatively more beneficial to lower-paid employees. In addition, many "second plans" are defined contribution plans which, by nature, can be more beneficial to younger (and thus often lower-paid) employees.

On the technical side, in computing the overall limit for participants covered under both defined benefit and defined contribution plans, it is inconsistent to compute and compare a fraction which is based on cumulative years of participation (the defined benefit fraction) with a fraction based solely on the current year of participation (defined contribution fraction). This last point takes into account the fact that in most cases the greater of the two proposed defined contribution fractions will be the "annual fraction." The net effect will be to prevent many employees from participating in more than one plan in a given year.

d. The reduction of the annual benefit limitation for participants who retire prior to age 65 should be complemented by a corresponding increase in such limits for people retiring after age 65. This is consistent with the current trend of providing incentives to older workers to encourage them to continue working past normal retirement age.

2. Section 4 of HR 6410 makes substantial changes in requirements plans must meet to be properly integrated with Social Security. The proposed changes appear to be arbitrary and capricious. The bill's approach is to integrate plans based on benefit cost. This is inconsistent with the design of defined benefit plans.

We question the assumptions used to arrive at the dollar limitations set forth in the safe-harbor integration provisions. We also question whether it is equitable to switch to the lower accrual rate above a certain level of pay.

HR 6410 provides for the nondiscriminatory coordination of plans with "certain federal and state retirement systems." The term "certain federal and state retirement system" is unclear and needs to be defined.

As we all know, integration is complex. The Trustees of the Social Security trust funds admit the system is currently out of actuarial balance and that changes must be made in the near future. We believe it would be in the best interest of all plan participants to defer any changes in the integration rules until the President's Commission on Social Security issues their report on what changes should be made.

3. Section 6 of HR 6410 extends rules applicable to Keogh plans to plans of "personal service corporations." Certain provisions of HR 6410 make changes in an effort to eliminate the inequities between corporations and noncorporations as far as pension plans are concerned. We find it inconsistent and unnecessary that the bill should require different rules for certain types of corporations. All corporations should be treated in the same manner.

4. Section 7 provides certain changes with regard to fringe benefit plans. Such changes would establish common nondiscriminatory-as-to-eligibility-and-benefits-tests to all statutory fringe benefit plans. Given the definition of statutory fringe benefit plans under HR 6410, we question whether the common rules noted above can be applied to such a diversified group of plans.

Edward H. Friend & Company applauds Representative Rangel for attempting to provide for a broader coverage base under pension plans and to revise what he believes to be inequities under the current pension system. We feel, however, that the changes made by HR 6410 will have an adverse effect on a majority of participants, that the bill creates unnecessary inequities among plans and that before any such changes are made the effect on participants and the economy must be carefully analyzed to assure the desired outcome. We do not feel that HR 6410 is productive legislation.

GASTROENTEROLOGY ASSOCIATES CO.,
East Lansing, Mich., June 16, 1982.

JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

DEAR SIR: It has come to my attention that there is activity afoot in the House Ways and Means Committee to reduce annual contributions per participant to define contribution plans, both pension and profit sharing as well as money purchase pension plans, etc.

In a time of unparalleled inflation, with the probable impending bankruptcy of Social Security, it seems ludicrous to me for the Government to take further action to prohibit participants in these plans from contributing to their own ultimate welfare. At some indefinite past time frame it has become very apparent to all of us that Social Security is not likely to provide for our retirement. It was never intended to so do, but I have the strong suspicion I shall never see ten cents from the Social Security fund. It simply represents another form of tax.

As a consequence thereof I must provide for my own retirement. It seems reasonable, at least, to presume that I could do so with untaxed dollars. To now debate, in any serious sense, a reduction of those amounts which I can set aside for my retirement seems unfair and unreasonable at least. To reduce these sums, with the rising cost of money, the rising cost of inflation, in a time when anything less than fifteen percent annual return represents "economics" which are inconsiderable, to reduce by as much as 33 percent the amount which I can contribute on an annual basis is something I find absolutely unacceptable. I cannot believe that anyone's constituents would willingly agree to this, offered the opportunity.

The time has come for the Government to begin, at least, to permit us to provide for our own retirement since they cannot (nor should they) provide for it. The impact of this is staggering to those of us who hope to retire in the next twenty years.

Respectfully,

RICHARD A. MARTENS.

General Foods Corp.,
White Plains, N.Y., June 18, 1982.

John J. Salmon,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

Dear Sir: General Foods Corporation, including its subsidiaries, maintains over 40 different defined benefit retirement plans in the United States. These plans, the majority of which are the result of extensive labor negotiations, cover more than 35,000 employees. Additionally, some 75 percent of these employees are eligible to participate in thrift and savings plans which are tax qualified as defined contribution plans.

While we are in sympathy with some of the issues that the subject bill attempts to address, we believe that the passage of ERISA in 1974 and the extensive legislative work since then to refine, adjust and improve the original legislation emphasizes the need to carefully assess the long-range impact of this most recent proposal.

For example, the Social Security System and its widely publicized financial problems have not yet been dealt with by the Congress. The bipartisan commission created by the President to develop proposals to restructure the system will not complete its work and issue its report until later this year. We therefore believe it is premature for the Congress to consider such fundamental issues as the integration of Social Security with the private pension system, prior to having the benefit of the commission's recommendations and deciding how Congress itself will deal with the Social Security System as a whole.

Furthermore, the portion of the proposed legislation dealing with the integration with Social Security, rather than serving to increase tax revenues, may actually increase the cost of private pension programs and thus decrease tax revenues. Our actuaries also inform us that the application of the integration limits proposed in this legislation may require the maintenance of individual balances of company contributions toward each employee's Social Security, thus further increasing administrative burden and cost.

Another objective of the proposed legislation is to reduce the maximum placed on an employee's retirement benefit and remove the indexing of such maximum benefit payable from a tax-qualified retirement plan. We believe there are two major reasons for not taking this action: (1) as the years pass and inflation pushes up wages, the pension benefits paid from a qualified plan of an increasing number of employees will be adversely affected, and (2) such action limits advance funding of pension benefits in excess of the limit since those benefits must be provided outside the tax qualified plan.

For these reasons, we recommend that the Ways and Means Committee postpone immediate action on H.R. 6410 to permit careful consideration of both the immediate and long-range implications of the effect of this legislation on the growth and financial stability of the private pension system in the United States.

Very truly yours,

C. L. Eddins,
Director, Benefits Planning and Administration.

State Bar of Georgia,
Atlanta, Ga., June 15, 1982.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

Dear Mr. Salmon: The State Bar of Georgia's Board of Governors representing 14,400 attorney's in Georgia met on June 12, 1982, and unanimously approved the attached Resolution in opposition to H.R. 6410, the Pension Equity Tax Act of 1982. We would hope that the Committee on Ways and Means will take the State Bar of Georgia's position into consideration when voting on this proposed legislation.

With warmest personal regards, I am,

Respectfully,

Allan A. Kirwan.

Proposed Resolution for Presentation to the Board of Governors from the Tax Section of the State Bar of Georgia—Re: H.R. 6410

Whereas H.R. 6410, the Pension Equity Tax Act of 1982, was introduced in Congress on May 19, 1982, a hearing was held on June 10, 1982 and proponents of the bill are seeking early enactment of the bill, possibly during June, 1982.

Whereas proponents of the legislation are representing that it will affect only a comparatively few highly-paid persons and will have relatively little adverse effects.

Whereas in fact, the legislation will affect large numbers of employees at all levels of compensation, will require the amendment of substantial numbers of employee benefit plans, if not all plans, and will have far-ranging effects which have not been given due consideration.

Whereas the far-ranging effects will include the termination or reduction of a substantial number of private pension plans, which are presently on a sound financial basis, and the increasing reliance on Social Security and other public pension systems which are not on a sound financial basis.

Whereas the effects may include reduction in capital formation, which is important to our country today.

Whereas this legislation will cause renewed emphasis to be placed on tax-shelter investments, many of which have little if any, social utility; now therefore, be it

Resolved, That the Board of Governors of the State Bar of Georgia urge the Congress of the United States, not to enact H.R. 6410 and not to enact any Pension bill without giving due consideration to it.

Global Marine Inc.,
Los Angeles, Calif., U.S.A. June 17, 1982.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

Dear Sir: Having experienced both the pre- and post- E.R.I.S.A. era as an Employee Benefits professional, I would like to express the following concerns of passage of The Pension Equity Tax Act of 1982 (PETA):

The present ERISA concept of imposing dollar limits on contributions to and benefits from qualified plans is too restricting in itself. To reduce these limits, eliminate inflationary limit increases and integrate all qualified plans under one limit would place severe burdens upon all industry. We would be even less able to attract top managerial personnel since employers with one plan could offer the same payments as multi-plan employers and cutbacks in benefits for these employees could result in reduced benefits for all employees.

The change in the Social Security integration concept would not only increase the record keeping and administrative burden of qualified plans but also require extensive plan redesign. Both of these are veyr expensive and detrimental to all employees since employers have limited amounts to fund benefit plans.

The nondiscrimination aspects of PETA (uniform coverage regardless of pay) contradicts sound, established benefit principles especially in the areas of group term life insurance and disability income beneifts.

There are other features of PETA that are not addressed here. However, they also seem to exemplify haste and a punitive nature. I propose that any future benefits legislation be approached with caution, study and control.

Sincerely,

R. O. Sorrells,
Manager, Compensation and Benefits.

Ross, Hardies, O'Keefe, Babcock & Parsons,
Chicago, Ill., June 7, 1982.

Congressman Dan Rostenkowski,
Chairman, House Ways and Means Committee, U.S. House of Representatives, Washington, D.C.

Dear Congressman Rostenkowski: On behalf of Great Lakes International, Inc., we would like to express our vigorous opposition to House of Representatives Bill No. 6410, "Pension Equity Act of 1982 ("H.R. 6410"). Great Lakes International, Inc., located at 2122 York Road, Oak Brook, Illinois 60521, is a public corporation, whose stock is actively traded on the New York Stock Exchange. The Company, founded in 1890, is in the highly specialized business of dredging and maintaining shipping canals and ports and currently employs approximately 850 men and women.

Although we feel H.R. 6410 is, as a whole, an ill-founded measure, our principal objections to the bill lies in the following areas:

(1) Reduction in the dollar limitations for contributions made to a defined-contribution or defined-benefit plan;

(2) Elimination of cost-of-living increases;

(3) Reduction of the aggregate limitation applied to a participant covered by both a defined benefit plan and a defined contribution plan from 140 percent to 100 percent, and

(4) Elimination of loans from plans to "key employees."

We believe that H.R. 6410 is short-sighted in that its adoption would, in the long run, lead to a reduction in private sector retirement plans and increased pressure on the public sector to provide such plans.

H.R. 6410 is a measure which, if adopted, would serverely curtail the establishment, maintenance and operation of privately sponsored retirement plans which countless numbers of Americans rely upon as a primary means of funding their retirement. Social Security, provided by the public sector, is sorely insufficient to provide a meaningful measure of benefits to those individuals contemplating retirement. The system's viability in future years is a serious and sustained question mark. Private retirement plans must be supported to insure their continued adoption and operation. However, H.R. 6410 rather than supporting such plans serves as a direct disincentive to their adoption.

To avoid the uncertainty and insignificant retirement benefits inherent in the Social Security System, the private sector has chosen to adopt and operate its own retirement system. These plans, governed by the Employee Retirement Income Security Act ("ERISA"), provide employees with retirement security—an element missing from the Social Security system. Employers are able to provide significant and meaningful retirement benefits to their employees through private means based on the fact that several tax advantages may accrue to employers by virtue of the adoption and operation of retirement plans. Without such tax incentives, employers would have no incentive to maintain and operate retirement plans for the advantage of their employees. The use of the private retirement plan would be significantly reduced, and the American workforce would once again be forced to rely on the public sector to provide for their retirement years. Unfortunately, the public sector is wholly unprepared to finance and provide adequate retirement benefits to individuals choosing or who are forced to choose retirement. Without adequate tax incentives to serve as inducements for employers to adopt private retirement plans, individuals would be unsure of whether they would be able to sustain themselves through retirement years.

H.R. 6410 reduces and in some cases eliminates the very tax incentives that have historically served to induce employers to maintain and operate private retirement vehicles. The reduction of these incentives would at the best significantly reduce the retirement benefit afforded to employees through private retirement vehicles. At the worst, the reduction of these tax incentives would sharply curtail the adoption of private pension and profit sharing plans. H.R. 6410 is a short-sighted plan that fails to assess the long-range damage and drain on the economy that would be caused to the private sector if the bill is adopted. To be sure, the bill will in the short run serve as a revenue saving measure. However, the long-term consequences by H.R. 6410 to both the public and private sectors could be disasterous.

This is especially true in view of the fact that the cost-of-living provision currently providing an essential check against the ravaging effects of inflation upon retirement income, is sought to be abolished through H.R. 6410. Seeking to abolish the cost-of-living increases in annual retirement benefits would essentially freeze an individuals retirement benefit in 1982, even though such individual may not retire until the year 2004. What may have been an adequate benefit in year 1982, may be wholly inadequate in 2004. Individuals may find themselves unprepared for retirement and the demands upon the public sector to provide for retirement would substantially increase.

The other provisions contained in H.R. 6410 are also cost inefficient, and the passage of such provisions would reduce the benefits provided to participants of such plans and curtail the adoption of the private retirement vehicle. We strenuously oppose the reduction in the annual limit that may be contributed to employees pursuant to a defined benefit pension plan or a defined contributions plan. In addition, we oppose the reductions in the aggregate limit applied to a participant covered by both a defined benefit plan and a defined contributions plan from 140 percent to 100 percent. Once again, these proposals are short-sighted and fail to take into account the impact such reductions would have upon the role of private retirement vehicles. A reduction in these benefits would serve as a direct disincentive to employers from adopting private retirement plans or continuing such plans. The cost to society and the government through the reductions in private retirement vehicles cannot be measured.

H.R. 6410 also seeks to drastically curtail the transactions whereby a plan provides loans to its participants. This provision is illogical and would adversely impact the majority of retirement plans in operation. A bona fide loan made by the plan to its participants, with bona fide collateral serving as security is a valid investment of a retirement trust. This type of loan is not subject to abuse, but provides a participant with a necessary source of capital while serving as a legitimate, practical and worthwhile investment for the retirement plan. There are, of course, loans from plans to participants which are subject to significant abuse. A loan from a plan with no or a small interest rate and no security is a case in point. However, rather than dealing with these types of abusive transactions, H.R. 6410 seeks to single out "key employees" for unfavorable tax treatment, by essentially prohibiting all loans even those which are legitimate investments. This blind sweeping approach to the perceived problem is inefficient and illogical. We readily support efforts to correct abusive situations. However, to correct these situations by adversely effecting nonabusive situations is an inefficient mechanism to approach the problem.

One of the most astonishing developments in business during the twentieth century is the growth of the private retirement plan. The continued growth in both the defined-benefit and defined-contributioin plans is now more than ever needed in view of the fact that the public sector is unable to provide meaningful retirement benefits. This, combined with the fact that the American work force is increasingly being forced to retire at earlier ages, mandates that private retirement plans be supported. However, H.R. 6410 fails to support such plans and its passage would severly diminish and curtail the growth of the private retirement vehicle. On behalf of Great Lakes International, Inc., we therefore respectively ask that you reject the passage of H.R. 6410. Your consideration of this matter is greatly appreciated.

Very truly yours,

CAREY F. COOPER.

GTE SERVICE CORP.,
Stamford, Conn., June 14, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

DEAR SIR: The introduction of H.R. 6410 creates a situation wherein the philosophy of the Administration is unclear as it relates to private pension systems. The Employee Retirement Income Security Act of 1974 evolved after many years of concern that private pensions were not adequate and imposed stringent requirements regarding, among other things, benefit accruals, vesting, and participation. The purpose of these rules was to ensure that this source of retirement income was secure. The Economic Recovery Tax Act of 1981 provides tax incentives for individual thrift, another source of retirement income. The remaining source, Social Security, has been under review for some time and its ability to meet the emerging needs of an aging population is suspect.

The provision of H.R. 6410 are contrary to public policy when the foregoing are considered.

GTE has one of the finest employee benefits programs. We provide our employees with a defined benefit pension plan as a corporate sponsored benefit. In addition, we have established numerous capital accumulation plans to assist our employees in saving for retirement or other major needs. The proposed reduction in the maximum limits imposed by IRC Section 415 could severely limit the amounts accumulated by employees under qualified plans. Also, the proposed loan limitation under IRS Section 401(k) could render this vehicle useless since historically, most employees are reluctant to commit funds where accessibility is limited.

Revising the Social Security integration rules is premature since the entire Social Security scheme is being reviewed. Changes must be made to the whole, not merely patched in pieces.

Imposing uniform nondiscrimination tests on statutory fringe benefit plans creates unnecessary complications for plans which generally are already nondiscriminatory.

All of the proposed changes to the Code would hamper savings, limit benefits, creates uncertainty and increase our administrative costs. Contrary to the bill's intent, it's questionable that the revenues sought will be realized. We suggest that changes of this import require more analysis and that further study be undertaken in coordination with industry committees. We will be happy to assist in this through our involvement with the ERISA Industry Committee (ERIC).

Sincerely yours,

W. L. HYLAND,
Vice President, Insurance.

THIGPEN & HINES,
ATTORNEYS AT LAW,
Charlotte, N.C., June 17, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. SALMON: The Pension Equity Tax Bill (H.R. 6410) pending before Congress makes rather drastic changes in the private pension system which is already extensively regulated by the Internal Revenue Service and the Department of Labor. As legal counsel for over 200 employer plans which would be directly affected by the legislation, I urge you to table any action on it until further hearings are conducted on the need for any so-called "reforms" in this area.

It would seem that our elected representatives should focus on the problems with the social security system and the complexities of the income tax structure, rather than the private pension area. As you know, the legislative reforms brought about by the Employee Retirement Income Security Act of 1974 have been fully implemented only recently by final regulations.

Please do not hesitate to call me if I may be of any assistance in your consideration of the proposed legislation.

Very truly yours,

C. WELLS HALL III.

HARCOURT BRACE JOVANOVICH, INC.,
New York, N.Y., June 16, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR SIR: The purpose of this letter is to enter our formal statement into public record regarding proposed House bill H.R. 6410.

Harcourt Brace Jovanovich, Inc. is a Fortune 500 company; it has been in business for more than 60 years. Since inception, HBJ has been a publisher of books for the general public and, more permanently, for the educational markets from kindergarten to graduate school, and it operates businesses in several other industries.

The Harcourt Brace Jovanovich, Inc. Pension Plan has been in existence as a defined benefit plan for over 20 years. Some Harcourt Brace Jovanovich, Inc. wholly owned subsidiaries not covered by the HBJ plan have defined contribution pension plans. Accordingly, House bill H.R. 6410, and its proposed changes in the tax regulations with respect to defined contribution plans and defined benefit plans, has specific implications for the employees of Harcourt Brace Jovanovich, Inc. and its subsidiary companies.

While we view H.R. 6410 in its entirety as being hastily prepared and for the most part unnecessary legislation, we will focus our comments at this time on three broad implications of this proposed legislation. These are:

(1) We are concerned that any pension legislation of this magnitude could hinder, rather than encourage, the growth of the private pension system

Current public policy is clearly supportive of the private pension movement as an important element in the three-tiered system providing retirement income.

Two of the three tiers, social security and private savings, have been experiencing severe difficulties—social security because of changing demographics and the current economic environment, and private savings because of the impact of inflation on the ability of Americans to save.

President Carter and now President Reagan have established commissions to study the problems of social security. Congress has recently (1978 Revenue Act and 1981 Economy Recovery Tax Act) passed legislation to encourage individual thrift.

At a time when two of the three tiers are under extreme pressure, it seems unwise to legislate further restrictive action on the third tier—private pensions.

(2) We question whether the government can realize any significant amount of indirect revenues by making these changes

It is our understanding that a stated purpose of the proposed legislation is to realize additional government revenues. The primary impact on employer contributions in plans of major corporations would be lower contributions for a handful of top executives (who are affected by lower benefit limitations). This will not generate significant revenue dollars for the U.S. government.

The other changes affecting corporate plans would require substantial corporate outlay in terms of design changes, new documentation, and explanations to employees, but would not necessarily decrease the overall level of tax-deductible employer contribution to these plans. In fact, for those employers who can afford to preserve their present plan formulas, the more restrictive social security integration rules would increase employer cost (and thereby decrease government revenues).

(3) We question whether any changes should be made in social security integration rules before larger issues concerning the social security system have been addressed

With the expectation that Congress will soon have to make significant changes in the social security system, it is premature to consider revisions in the manner in which private pension plans are permitted to coordinate with the public system. We urge Congress to address these issues in their proper and orderly sequence.

We urge Congress to assess the need for the proposed legislation more closely. If such legislation is indeed needed, we ask for more time to study and discuss the implications of the proposed changes. In any event, we feel strongly that the types of changes in this bill should not be the result of a hasty search for further government revenues.

Sincerely,

JACK O. SNYDER,
Executive Vice President.

HARRIS TRUST & SAVINGS BANK,
Chicago, Ill., June 18, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR SIR: The purpose of this letter is to enter a statment on behalf of the Harris Bank into the public record regarding proposed House Bill HR 6410.

The Harris Trust and Savings Bank is a 100 year old, seven billion dollar asset bank institution with 3,415 employees. The bank maintains a defined contribution plan and a defined benefit plan. Our comments will focus on the effect H.R. 6410 will have on our employees.

Changing the 1.4 defined contribution plan and defined benefit plan limit to 1.0

This change would reduce the benefits available to 2,777 or 81% or our employees. The following table shows by $12,000 annual salary increments the number of employees whose benefits would be reduced:

Number of of employees whose benefits will be reduced

Annual salary:	
To $12,000	332
$12,000 to $24,000	1,602
$24,000 to $36,000	445
$36,000 to $48,000	217
$48,000 to $60,000	95
$60,000,000 and over	86
Total (or 81 percent of all employees)	2,777

Reducing the 1.4 maximum to 1.0 is a service issue, not a salary issue. The 1.4 was established so younger employees could earn full plan benefits. Changing the limit to 1.0 would reduce the benefits of all Harris employees hired prior to attaining age 36. If the 1.4 limit is reduced, the benefits of our career employees will be less than the benefits employees could earn by working for several employers with similar benefit plans.

Do not enact legislation that would reduce the pension benefits of 81 percent of our employees. Retention of the 1.4 defined contribution plan and defined benefit plan limit is essential if we are to fulfill our obligations under our retirement plans.

Repeal of cost-of-living adjustment for defined benefit plan and defined contribution plan dollar limits

The proposed limits of $30,000 and $90,000, if unchanged, will eventually limit the benefits of a large number of participants. As the number of employees adversely affected by the dollar limits increases, pressure will mount for changing the limits. This will result in periodic adjustments and disjointed administration of plans. The better approach is to index the benefit limits.

Indexing is preferable to periodic adjustments. Indexing permits funding of the full benefits due participants from defined benefit plans on an orderly basis. Under a periodic adjustment system, many plan participants would not receive the full benefits which might otherwise be made available to them because the status of fund assets or the financial condition of the employer might not permit a benefit increase at the time of an unscheduled increase in the pension maximum. Further, under the periodic adjustment approach, where plan benefits are increased following an increase in the maximum, such benefits would not be as well funded as they would be under indexing. As a result, participants would have less assurance of receiving their formula benefits. Indexing clearly is essential for systematic funding.

It must be recognized that the imposition of ceilings has vastly different effects for defined benefit plans and defined contribution plans.

Under a defined benefit plan when there is an increase in the maximum, the plan participants can realize an immediate increase in their plan benefits on a retroactive basis. On the other hand, because contributions to a defined contribution plan are made each year for that year, an increase in the ceiling only applies on a prospective basis. A participant's benefit is the value of his or her defined contribution plan assets; the value does not change because the benefit limit is increased.

For equity between the different types of benefit plans and for the systematic funding of defined benefit plans, it is essential that the dollar maximums be indexed.

Certain loans, treated as distributions

For years, the Harris defined contribution plan has permitted employees to borrow part of their account balance. Employees taking advantage of the loan provision are charged a current rate of interest and the loans must be paid in five years. All loans have been paid when due.

The loan option has become an important part of the financial plans of the participants. They know that loans are available for unforseen emergencies and for major expenses, such as home acquistion and college tuitions.

The bill would treat loans to higher paid employees (called "key employees") as taxable distributions. The stated purpose of the change in the loan rules is to prevent the highly paid from abusing the loan privilege. Defining key employees as the highest paid 15 percent makes loans by Harris employees who earn in excess of $34,900 per year subject to tax. These are not, "highly paid abusers of the loan provisions." Defining key employees as the highest paid 15 percent means the thoughtful financial plans of this group cannot be implemented. It also means employees with ambitious career objectives are precluded from considering this as a source for financing the purchase of a home or for educational expenses.

The Harris believes current laws prohibit sham loans and give the government authority to prevent abuse. Therefore, we oppose treating loans by any employee as a taxable distribution. However, if Congress feels such a provision is necessary in H.R. 6410, the highest paid 15 percent is much too broad a definition of key employees.

Technical comments

Bill Section 2(c)(3) titled "Defined contribution fraction defined." Subsection (A) changes the defined contribution fraction to the greater of: (1) the annual fraction; or (2) the cumulative fraction. Previously, only the cumulative fraction was used. The change will be detrimental to employees of firms with cyclical earnings. The change means it is no longer possible, in years when earnings are good, to make contributions that make up for the fact that little or no contribution can be made in years when earnings are poor.

Bill Section 1(c)(2) titled, "Continuation of adjustments in participants' compensation for high three years." This section permits the indexing of the benefits of terminated participants whose benefits are below the defined benefit plan dollar maximum. It is illogical to permit the indexing of the benefits received by some terminated participants and not others. Further, the indexing should not be limited to the defined benefit plan dollar maximum. An employee retiring at age 65 with a $35,000 annual pension will reach the $90,000 maximum several years prior to normal life expectancy with a 6 percent annual increase in the cost of living. The Harris urges that the continuation of adjustments be for all terminated employees and that the indexing not be subject to the defined benefit plan dollar maximum.

Section 4 titled, "Nondiscriminatory Coordination of Plans with Certain Federal and State Retirement Systems." The proposed social security integration rule changes need thorough analysis. For example, the proposed rules would substantially reduce the vested deferred benefits which could be earned by younger employees from defined benefit plans. To illustrate the change, the current social security offset for an employee earning $15,000 a year and terminating at age 34 with ten years of service is about $1,300. Under the integration rules in H.R. 6410, the offset could be $3,000. Is it the intent of H.R. 6410 to reduce the annual vested defined benefit to which this individual is entitled by $1,700 per year?

Section 4(a)(4)(C) titled, "Employee participant in both defined contribution plan and defined benefit plan." This section provides that employers maintaining both a defined contribution plan and a defined benefit plan and who choose to integrate with social security must integrate the defined benefit plan. Previously, employers have had the choice of integrating either plan. Requiring employers who have chosen to integrate the defined contribution plan to change the integration to the defined benefit plan imposes unnecessary legal and actuarial fees. The current and proposed integration rules are equitable between the two types of plans. Therefore, employers should be able to select which plan they want to integrate when their employees are covered by both a defined benefit plan and a defined contribution plan.

I urge you to take the time to evaluate all the tax and social implications of this bill. This letter has described the devastating effects it has on our employees. I am certain it will have similar effects on the employees of other companies. As an employer and as a fund manager Harris believes that changes should be made only after all of the disciplines have had adequate time to review the changes and report their effects on the benefit system.

Sincerely yours,

JOHN L. STEPHENS,
Executive Vice President.

HERZ, LEVIN, TEPER, SUMNER & CROYSDALE, S.C.,
Milwaukee, Wis., June 11, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Way and Means,
Washington, D.C.

DEAR MR. SALMON: The purpose of this letter is to express my deep and strong opposition to proposed House bill H.R. 6410.

Our law firm actively represents a substantial number of clients in employee benefit and employment relations matters. My own experience covers sixteen years and involves representing corporate organizations with as few as two employees ranging to organizations employing well over 3,000 employees.

I fully endorse and support the formal statement provided by Hewitt Associates and communicated to its clients in a special report dated June 4, 1982, a copy of which is enclosed. I further support strongly the testimony given in congressional hearings on June 8 by Donald Christl of the Reinhart, Boerner, VanDeuren, Norris & Rieselbach, S.C. law firm.

A very important point that may be overlooked in the zeal to attack perceived tax advantages for higher compensated executives and professionals is that hundreds of thousands of rank and file employees are covered by qualified pension and profit sharing plans sponsored by these very same highly compensated persons. Indeed, a primary source of savings and retirement income for these rank and file employees is provided by these plans. Misguided efforts to reduce the value of qualified plans to executives and professionals would have the highly undesirable effect of discouraging them from providing substantial benefits for rank and file employees.

I respectfully request that this statement in opposition be distributed to appropriate committee members who are responsible for evaluating and considering H.R. 6410. I appreciate your cooperation in this matter.

Very truly yours,

David W. Croysdale.

Hewitt Associates,
June 4, 1982.

Mr. John Salmon,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

Dear Sir: The purpose of this letter is to enter our formal statement into public record regarding proposed House bill H.R. 6410.

Hewitt Associates is a nationwide firm of consultants and actuaries in the human resources field. We have consulted with major U.S. corporations on employee benefit design for over 40 years and have seen the evolution of government impact on employee benefits from a wide range of corporate perspectives.

We want to focus our comments at this time on the broader implications of the proposed legislation.

1. *We are concerned that any pension legislation of this magnitude could hinder, rather than encourage, the growth of the private pension system.*

Current public policy is clearly supportive of the private pension movement as an important element in the three-tiered system providing retirement income.

Two of the three tiers, social security and private savings, have been experiencing severe difficulties—social security because of changing demographics and the current economic environment, and private savings because of the impact of inflation on the ability of Americans to save.

President Carter and now President Reagan have established commissions to study the problems of social security. Congress has recently (1978 Revenue Act and 1981 Economic Recovery Tax Act) passed legislation to encourage individual thrift.

At a time when two of the three tiers are under extreme pressure, it seems unwise to legislate further restrictive action on the third tier—private pensions.

2. *We question whether the government can realize any significant amount of indirect revenues by making these changes.*

It is our understanding that a stated purpose of the proposed legislation is to realize additional government revenues. The primary impact on employer contributions in plans of major corporations would be lower contributions for a handful of top executives (who are affected by lower benefit limitations). This will not generate significant revenue dollars for the U.S. government.

For example, drawing on our own experience of making yearly benefit projections for over half a million individual employees of major corporations, we find that substantially less than 1 percent of these employees currently have projected age 65 pension benefits over the proposed $90,000 limit.

The other changes affecting corporate plans would require substantial corporate outlay in terms of design changes, new documentation, and explanations to employees, but would not necessarily decrease the overall level of tax-deductible employer contributions to these plans. In fact, for those employers who can afford to preserve their present plan formulas, the more restrictive social security integration rules would increase employer cost (and thereby decrease government revenues).

3. *We question whether any changes should be made in social security integration rules before larger issues concerning the social security system have been addressed.*

With the expectation that Congress will soon have to make significant changes in the social security system, it is premature to consider revisions in the manner in which private pension plans are permitted to coordinate with the public system. We urge Congress to address these issues in their proper and orderly sequence.

4. *We are concerned that attempts to limit loan privileges from plans utilizing Section 401 (k) of the Code will defeat a portion of Congress' original intention of establishing such plans (provided for as recently as the Revenue Act of 1978).*

Among the important justifications for Section 401 (k) is the broad national goal of encouraging individual thrift and deferring income until retirement. The extent to which this goal is achieved is important from a national perspective: the development of individual capital accumulation accounts should help ultimately to relieve pressure both on social security and on private pensions (especially relieving pressure to index such plans).

Based on our experience in testing plan designs, we have found that the more a capital accumulation plan restricts accessibility of participant money, the less the eligible participants will utilize the plan for optional employee deposits.

To tax the proceeds of loans as income will have the simple negative effect of discouraging plan participation (especially when rules already exist requiring the orderly repayment of such loans).

We urge Congress to assess the need for the proposed legislation more closely. If such legislation is indeed needed, we ask for more time to study and discuss the implications of the proposed changes. In any event, we feel strongly that the types of changes in this bill should not be the result of a hasty search for further government revenues.

Sincerely,

PETER E. FRIEDES, *Chief Executive.*

GEO. A. HORMEL & CO.,
Austin, Minn., June 10, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: The purpose of this letter is to enter our formal comments regarding proposed House Bill H.R. 6410.

We wish to focus our comments on the broader implications of the proposed legislation.

I. We question whether any change should be made in social security integration rules before larger issues concerning the social security system have been addressed.

II. We are concerned that legislation of this magnitude could hurt, rather than encourage, the growth of the private pension system.

This is clearly contrary to the current philosophy of the private pension system being an integral part of the three tiered retirement income system. Already two of these three tiers, social security and private savings, have experienced severe difficulties.

III. We question whether or not the government can realize any significant amount of indirect revenues by making the changes suggested.

Since the primary impact on employer contributions in plans of major corporations would be to reduce these contributions for a handful of top executives there should be an insignificant generation of revenue dollars.

IV. Other changes reveal substantial financial outlay in terms of design changes, documentation and explanation to participants with an end result of questionable decreases in the level of employer tax deductible contributions to these plans.

We urge you to assess the need for the proposed legislation more closely. If it is indeed needed, we ask for more time for study and discussion of the implications of the proposed changes. In any event, we strongly believe that the type of changes, in this Bill should not be the result of a hasty search for government revenues.

Sincerely,

R. L. KNOWLTON,
President and Chief Officer.

E. C. ALSAKER,
Senior Vice-President and Treasurer.

HUNT-WESSON FOODS, INC.,
Fullerton, Calif., June 14, 1982.

Mr. JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

DEAR MR. SALMON: Enclosed for your information and file are copies of letters sent to the Senate Finance Committee and the House Ways and Means Committee emphasizing our Company's position on the proposed H.R. 6410.

Sincerely,

BRENT AYRE,
Manager, Pension/Profit Sharing Plans.

Enclosures.

We understand a bill similar to H.R. 6410 will be introduced into the Senate. Hunt-Wesson Foods, Inc., as a major employer with over sixty (60) employee benefit plans, strongly opposes any bill similar to H.R. 6410 an urges you to vote against such a bill, if it is introduced into the Senate.

Many of the provisions of H.R. 6410 (i.e., the reduction of benefit limitations which severely decreases the amount of income available to employees at retirement, the reduction of Social Security integration levels which significantly increases employer costs, the imposition of nondiscrimination tests for certain welfare plans which further increases already burdensome administrative costs, the impositio of a maximum excluded amount of benefit for estate tax purposes which conflicts with ERISA's original intent to protect survivors' benefits and the negation of loan provisions for participants of 401(k) plans and for key employees of other qualified plans which both limits flexibility and reversely discriminates in favor of non-key employees) would not only be viewed negatively by employees and employers, but would probably lead to substantial curtailments of benefits to all employees, with the consequence of employees looking to the already financially-troubled Social Security system for help in making up the cutbacks in private plans. Additionally, if other employers feel as strongly about H.R. 6410 as Hunt-Wesson, the PBGC could possibly feel the effects of this bill through the onslaught of plan terminations by employers who either cannot or will not absorb the increased costs.

Proponents of H.R. 6410 predict that it will increase federal revenues by reducing available tax deductions for contributions to retirement plans. This bill might simply induce businesses, especially small businesses, to seek the same tax deductions for purposes less productive than employee retirement plans. Additionally, any savings that are realized through enactment of H.R. 6410 could come at the cost of depriving millions of Americans of future finanical security under retirement plans maintained by private industry.

Sincerely,

FREDERICK B. RENTSCHLER, *President.*

Hunt-Wesson Foods, Inc. as a major employer with over sixty (60) employee benefit plans, strongly opposes and urges you to vote against this bill.

Many of the provisions of H.R. 6410 (i.e., the reduction of benefit limitations which severely decreases the amount of income available to employees at retirement, the reduction of Social Security integration levels which significantly increases employer costs, the imposition of nondiscrimination tests for certain welfare plans which further increases already burdensome administrative costs, the imposition of a maximum excluded amount of benefit for estate tax purposes which conflicts with ERISA's original intent to protect survivors' benefits and the negation of loan provisions for participants of 401 (k) plans and for key employees of other qualified plans which both limits flexibility and reversely discriminates in favor of non-key employees) would not only be viewed negatively by employees and employers, but would probably lead to substantial curtailments of benefits to all employees, with the consequence of employees looking to the already financially-troubled Social Security system for help in making up the cutbacks in private plans. Additionally, if other employers feel as strongly about H.R. 6410 as Hunt-Wesson, the PBGC could possibly feel the effects of this bill through the onslaught of plan terminations by employers who either cannot or will not absorb the increased costs.

Proponents of H.R. 6410 predict that it will increase federal revenues by reducing available tax deductions for contributions to retirement plans. This bill might simply induce businesses, especially small businesses, to seek the same tax deductions for purposes less productive than employee retirement plans. Additionally, any savings that are realized through enactment of H.R. 6410 could come at the cost of depriving millions of Americans of future financial security under retirement plans maintained by private industry.

Sincerely,

FREDERICK B. RENTSCHLER, *President.*

INSURANCE-RETIREMENT-SERVICES, INC.,
Nashville, Tenn., June 17, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR SIR: This is a written statement for the printed record of the hearing on H.R. 6410, the Pension Equity Tax Act of 1982. As required, five copies of this statement are enclosed.

The statement is filed by: Kenneth L. Ross, President, Insurance Retirement-Services, Inc., P.O. Box 15891, Nashville, TN, (615) 373-0575.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

(1) The lowering of maximum benefit and contribution limits and elimination of the automatic cost-of-living escalator will have a severe adverse effect on lower-paid workers. Reduction of the maximum benefit if payment is made prior to age 65, in a defined benefit plan, will discourage early retirement and have an adverse effect on the unemployed and underemployed.

(2) Elimination of plan loans to key employees will have the effect of eliminating loan provisions altogether and will cause severe economic hardship to many American workers.

(3) The change in defined benefit plan integration to allow an offset only with respect to Social Security benefits paid for by the employer who maintians the plan should not apply to plan participants who have adequate service to receive full benefits.

(4) There is no rational basis for singling out employees in certain industries to receive reduced retirement benefits.

(5) We support the concept that non-discriminatory rules should apply in statutory fringe benefit programs.

(6) No new legislation is needed in the estate tax area.

It is my general opinion, and that of my firm, that this proposed legislation is an effort to completely undermine the private pension system at a time when our increasing aging population is in dire need of the means to be self-sufficient. Each year the ratio of active workers to those who are dependent on them for inter-generated monetary transfers gets smaller. Each year the inability of the public Social Security system to anticipate inflation becomes more obvious. This legislation would introduce the worst elements of the Social Security system into the private retirement system, would virtually negate much of Employee Retirement Income Security Act of 1974, and would work its greatest hardship on lower-paid workers who can least afford reductions in retirement benefits. My specific objections and suggestions are outlined below:

(1) H.R. 6410, Section 2: Lowering the maximum permissible benefits and contributions would have its most drastic effect on lower-paid workers. Plan formulas would be adopted (or revised) to provide the highest paid participants with the lower benefit or contribution and, in the process, benefits or contributions for lower-paid workers, who can least afford reduced pensions, would be cut. For example, if a company whose owner earns $300,000 per year were to establish a defined contribution plan under the present law, a contribution formula of 15 percent of compensation wouid provide the owner-participant with a near-maximum contribution of $45,000. If that same company were to establish a plan under the terms of the new bill, a contribution formula of 10 percent of compensation would provide the owner-participant with the maximum benefit and it is likely that the selected formula would not exeeed that percentage. Thus, the contribution for a worker who earns $10,000 per year would be $1,000 annually rather than the $1,500 annual contribution which could be available under present law. There would be a similar result in a defined benefit plan. In viturally every instance where a reduced maximum would cause reductions in benefits or contributions for the highly-paid, there will be resultant reductions in benefits for lower-paid workers if the bill is enacted. The lower-paid workers will feel the effect of the reductions more severely than will the higher-paid workers, if the bill is enacted. The lower-paid workers will feel the effect of the reductions more severely than will the higher-paid workers, who will have other capital (more capital, in the case of owner-participants, because of savings in retirement plan contributions) available for retirement savings, if the bill is enacted.

The proposal to cut back the maximum benefit under a defined benefit plan if payment is made before age 65 (55 under present law) is contrary to public policy in that it discourages early retirement. This is, perhaps, the most damaging proposal in the entire bill. By requiring a cutback in the maximum benefit (in addition to the actuarial cutback already required under present law, in integrated plans) the terms of the bill would make it impossible, in many cases, for higher-paid workers to retire before age 65 at an income level even near to what they need to maintain their current life styles. The absolutely certain, and immediate, effect of enactment of this provision would be reduced employment at all levels as higher-paid, traditionally white male executive is forced to remain on the job. Fewer opportunities for advancement at all levels would open up for the traditionally unemployed and underemployed minorities. At a time when unemployment is at near-depression levels, it is truly unthinkable to even propose legislation of this type.

Removal of automatic cost-of-living increases from the maximum benefit and contribution sections of the law would result, again, in lower contributions and benefits at all levels. This proposal is particularly bad because private sector plans would be saddled with the most pronounced weakness in the public sector Social Security system, which is the inability to cope with spiraling inflation.

(2) H.R. 6410, Section 3: This bill would effectively eliminate loans to certain key employees and, in the process, to all employees. It is unlikely that many plans would contain any loan provisions if the company owners and officers were not entitled to receive them (without being taxed on the loan amounts). It seems inconceivable to prohibit workers from borrowing against what is, in many instances, their largest asset, without incurring tax liability. I find it incredible that the proposed effective date for this provision is May 19, 1982. This could literally cause financial ruin to plan participants throughout the nation, who are now borrowing money in accordance with the terms of the law as it is now written and who are totally unaware of this bill.

In this section the bill shows a total insensitivity to the needs of workers at all levels to use their savings to finance current emergency needs. This comes at a time when it is expecially difficult to obtain commercial financing. Under present law, each participant loan must be reported to the government annually. If it is believed that there are abuses in the use of plan loan provisions, then I suggest stricter enforcement of the present law. The guidelines for loans to participants are clearly set forth in E.R.I.S.A. and a mechanism for monitoring loan activity has been established as a part of the annual reporting requirements. Surely, proper enforcement is a better solution to any participant loan problems than abolition of what is a most essential part of any savings system, for many American workers.

(3) H.R. 6410, Section 4: This section appears to be contradictory to the rest of the bill in that reduced Social Security offsets will cause increase costs and, thus, increased tax deductions. More importantly, the proposed reduced offset should only apply with respect to plan participants who receive reduced pensions because of short service. In other words, the full present offset should be allowed with respect to any participant who has enough service with his or her present employer to receive a full benefit under that employer's plan.

(4) H.R. 6410, Section 5 & 6: Because recent legislation, already enacted, has eliminated the means for discriminatory abuse in the professional corporation retirement plan area, it is our belief that there is no rational basis for choosing the employees in certain industries and occupations to receive less favorable tax treatment than others. Also, this section makes no provision for protection of already accrued benefits.

(5) H.R. 6410, Section 7: We generally support the principle of prohibiting discrimination with respect to statutory fringe benefits.

(6) H.R. 6410, Section 8: Present law, generally, denies an estate tax exclusion to those who receive favorable income tax treatment with respect to death payouts from qualified plans. It is our belief that no further legislation is necessary in this area.

In summary, we believe that H.R. 6410, if enacted, would make a mockery of all efforts during the past decade to create retirement plan equity. The bill was poorly conceived and its precepts show total disregard for the rights and problems of American workers. The bill has little in the way of safeguards for already accrued rights and its enactment will cause billions of dollars of administrative expense to companies who can ill afford such costs. Beyond all of this, the enactment will cause billions of dollars of administrative expense to companies who can ill afford such costs. Beyond all of this, the enactment of this bill would certainly trigger a reduction in the number of workers who are guaranteed retirement safety, as plans are terminated or not implemented because of the provisions contained in the bill.

Sincerely,

Kenneth L. Ross.

Internal Medicine Associates of Yakima, Inc., P.S.,
Yakima, Wash., June 15, 1982.

Ways and Means Committee,
Washington, D.C.

To Whom It May Concern: I am outraged by the blatant discrimination of H.R. 6410 introduced by Congressman Rangel in the Ways and Means Committee. H.R. 6410 obviously singles out certain groups of small, closely held business and professional corporations for very harsh and unfavorable treatment.

As an incorporated professional, I consider myself a small businessman in every sense of the word. I have no benefits other than what I can provide for myself and my employees. There are no stock options available in a closely held corporation. There are no generous government pensions paid for by taxpayers' money. The private pension plan maintained by our corporation for my employees and me is especially important to us. There is little confidence in the bankrupt Social Security system. It is both disappointing and discouraging that some members of Congress now intend to substantially alter the one thing that has worked well for us—our private pension plan.

At the same time, I recognize the budget crisis facing Congress and, like all Americans, I am happy to contribute my share. If existing pension contribution levels are determined to be too high by Congress, then I feel all pensions should be reduced in an equitable manner, including those for employees of large corporations and those of government employees.

The pension laws have been carefully contructed by Congress and were subject to a comprehensive Act as recently as 1974 (ERISA). The private pension system is an important one to the country which should not be changed without careful consideration of all the alternatives. In particular, it should not be changed in a manner so obviously discriminatory to a particular group such as small, closely held corporations.

May we please have your support and vigorous opposition to H.R. 6410.

Yours very truly,

John S. Barany
(And others).

Statement of William B. Shearer, Jr., Esq., President, International Association for Financial Planning, Inc.

Mr. Chairman and members of the committee, I am William B. Shearer, Jr., of the law firm of Dillard & Shearer, P.C., Atlanta, Georgia. I am officially here today in my capacity as President and designated spokesperson for the International Association for Financial Planning, Inc. I am also appearing individually since my educational background includes a Masters of Law in Taxation from New York University and I have more than fifteen years of experience in counseling owners and employees of small business on tax, business and estate planning matters. Both professionally and as the IAFP's spokesperson, I am vitally concerned about the negative impact that H.R. 6410 will have on retirement planning for small businesses, their employees and families.

The International Association for Financial Planning, Inc. (IAFP) is an international, non-profit, membership association with over 10,000 members and 70 chapters throughout our 50 states. Our members are individuals who are trained and educated in one or more of the many industries involved in financial planning. These areas of training include accounting, insurance, real estate, securities and law. A majority of our members are involved in providing personal financial advice, products and services to more than 3 million taxpayers who are owners or employees of small businesses or professional corporations. Past membership surveys indicate that our members are involved in advising clients in the purchase of approximately 10 billion dollars of investments and insurance products each year. A large portion of these purchases involve retirement plans maintained by small businesses.

One of the major responsibilities of the financial planner and his or her client is to establish appropriate retirement goals for the client and then achieve them. Given the historical impact of taxes and inflation, the abilty to accumulate a retirement fund has been difficult at best. In fact investments made by a taxpayer from income subject to a 50 percent tax must appreciate more than 120 percent to net the taxpayer the original amount that had to be earned to make the investment.[1] Even

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[1] A taxpayer earning $10,000 subject to a 50% tax will have $5,000 to invest. If the $5,000 is invested in an investment which appreciates 125 percent the investment will then be worth

Continued

though the Employee Retirement Income Security act of 1974 reduced the amount that could be contributed to qualified plans it did provide cost-of-living adjustments to the reduced contribution amounts. Since that time our members have been able to convince their clients to keep their old plans and have directed new clients and money into new qualified retirement plans. It is satisfying for us, as financial planning professionals, to assist our clients in the transfer of capital through legitimate tax deductible methods into a medium that will be managed conservatively for the benefit of themselves and others who helped the business succeed.

We believe that out client's ability to manage the retirement plan trust funds rather than being required to transfer this responsibility to outside institutions is one of the major incentives for electing qualified retirement plans. As you know the investment track record of third party institutions such as banks leave a great deal to be desired. Another very important factor in a client's decision to establish these plans is the ability to borrow from the plan when in need. Indeed, if these choices were not available we fear that many plans which are providing savings and other benefits for employees today will not be here tomorrow.

Although we believe that many of the changes in ERISA were beneficial, the confusion it bought the American taxpayer and small business owners has caused the termination of many retirement plans. The lawyers, accountants and pension consultants have made more money but the business owner lost faith and threw in the towel because of the additional cost and confusion the law created. The real losers, however, were the employees who were covered by these retirement plans. Other losers are the taxpayer who will have to contribute to social security or other welfare programs to replace the income that private industry would have provided these employees on their retirement. Since my graduation from law school in 1966 the number of new tax laws and major tax changes that have occurred has been astounding. The lack of consistency and numerous changes that continue to be made in the field of taxation and business regulation are creating a panic and a growing wave of distrust by the American public. Too many times today do our members hear their clients talk and dream of ways to avoid, eliminate and, if you will, evade the constant flow of changes and restrictions placed on their ability not only to earn but to accumulate and preserve funds for their financial independence.

Most of the changes proposed in H.R. 6410 will again test the business owner's willingness to continue to pay for regulatory changes. Our best estimate is that many will choose to leave the regulatory battlefield by eliminating all retirement and fringe benefit programs for their employees. They will blame the U.S. government. Their solutions to their tax and financial problems will be to find other ways to financially protect themselves. Their alternatives may include going "underground" with cash or continuing to use the tax lottery and questionable tax shelters to avoid the payment of more than half of their net income to federal and state taxes. As a practitioner and as President of an Association that has regular contract with more than 3 million responsible citizens, I can assure your that our membership will again have to argue unsuccessfully, time and time agains, with their clients about why they should not invest in tax schemes. Once more, sound economic ventures that should receive investment capital will lose to the tax dodges.

The IAFP is also concerned about the additional pressure that H.R. 6410 will place on the social security system. When taxpayers leave the work force their need to spend money decreases but does not stop. The more restrictions that are placed on the private sector's ability to assist their employers in achieving financial independence or accumulating funds for retirement, the greater the dependence must be on social security or some other welfare system for their income. So long as the benefits currently provided by our social security system remain, citizens will continue to develop a psychological dependence and expectation for its rewards. In fact most citizens today are developing a philosophy that they are entitled to a certain standard of living which will be provided by the U.S. government in the event of their disability or retirement. We believe this attitude is detrimental to the financial welfare of our country and the free enterprise system that has made it the strongest country in the world. We challenge Congress to create new incentives for transferring the retirement income responsibility to the private sector.

$11,250. Assuming the investment was a capital asset and had been held more than one year the sale of the investment will produce a gain that will be taxed as a long term capital gain. Thus, on sales proceeds of $11,250 less the $5,000 originally invested, the taxpayer will have a $6,250 gain. The tax on the gain will be 20% of $6,250 for a tax of $1,250. If the tax of $1,250 is then paid from the $6,250 gain the taxpayer is left with $5,000 of gain. If the $5,000 gain is added to the original $5,000 investment, the investor then has the $10,000 that was initially earned.

In the interest of your time and to allow others who are to testify today in opposition to H.R. 6410, I want to limit my specific comments about H.R. 6410 and will submit further written testimony at a later date.

The IAFP believes that the following provisions of H.R. 6410 will not serve the best interest of this country, our economy or provide any real assistance in balancing the budget of the United States regardless of the estimated revenues that it will produce:

(1) The reduction of deductible contributions to defined contribution plans to $30,000 and to defined benefits plans to $90,000, the repeal of cost-of-living indexing, and the elimination of the 1.4 Rule will cause the termination of many plans. These are plans that benefit the low paid as well as high paid employees. In addition, the contributions that would have been made under the existing law will be channeled in less productive directions, against the advice of financial planners, lawyers and accountants. Despite the fact that most U.S. citizens are motivated to voluntarily pay their fair share of tax, we, as financial planning professionals find that everytime a new tax law changes the rules, we have to again defend our tax system and argue with clients about the need to comply and plan within the limits of the law rather than use tax avoidance schemes.

(2) The reduction of benefits if employees retire at age 55 will force the older employees to stay in their jobs, thereby denying advancement to the younger generation. In our opinion, Congress should concentrate on moving the older members of our work force into private retirement programs rather than keeping older employees in the work force to the exclusion of younger employees who should be advancing up the ladder of responsibility.

(3) The prohibition against loans to employes will eliminate one valuable aspect of ERISA that has allowed many employers to continue old plans and initiate new plans. The rollercoaster track record of our economy in the last two decades has created serious concerns within the American business community about any type of investment that limits access to the funds invested or the profits from the investment for long periods of time. We all know that emergencies occur and enexpected financial needs arise which require prudent investors to plan for these contingencies. The loan to participants provision has been a key element in the decision making process of establishing qualified retirement plans.

(4) The Bill changes the social security integration provisions and places a limit on the estate tax exclusions provided for employer contributions to the plan. Both of these changes discriminate against the higher paid employee. We believe that there are enough disincentives to production, free enterprise and self improvement in our system today without adding these provisions. Frankly, more economic incentives should be given for those who accelerate the productivity of our economy.

(5) There are several provisions of the Bill which discriminate against professional service corporations in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. Those provisions: (a) Require full vesting after an employee is employed for three years; (b) prohibit integration with social security; (c) require a bank trustee; (d) prohibit voluntary contributions; (e) prohibit payment prior to the age of 59½ without a time penalty; (f) require payments after age 70½; and (g) require a defined contribution limit of 15 percent of pay or $30,000, whichever is less.

We cannot understand the logic or reason for singling out these small businesses from all of the other businesses in our country.

On the positive side, there is one provision of the Bill that the IAFP encourages the Committee to consider by itself. That is the provision that increases the KEOGH limits from $15,000 to $30,000. In the past, Congress has allowed businesses that incorporate to obtain larger pension and other fringe benefits than those that do not. The IAFP believes in parity for the self employed and the corporate employee but believes that parity should be achieved by increasing the lower KEOGH limits to that of the current corporate limits rather than reducing retirement incentives as proposed by H.R. 6410.

In concluding, our Association believes that the enactment of H.R. 6410 will create another level of confusion for the taxpayer, revenue for the pension plan consultants and a new incentive for the tax shelter industry to find more ways to take the money that would otherwise go to employees and their families at death, disability or retirement. We urge the Committee to consider the negatives of this Bill and to act in a manner that will encourage small businesses and their employees to save more, not less, for their future and that of the families who will someday be without the person on whom they have been dependent for their own income.

Thank you Mr. Chairman.

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Washington, D.C., June 18, 1982.

Hon. DANIEL ROSTENKOWSKI,
Chairman, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI: The Interstate Natural Gas Association of America (INGAA) is a non-profit trade association whose membership includes virtually all of the long distance gas transmission companies subject to the jurisdiction of the Federal Energy Regulatory Commission.

INGAA is concerned about the effect H.R. 6410 will have on the qualified plans of large corporations. We believe that such sweeping legislation is not in the best interest of either the corporate taxpayer or its employees. Frankly, we do not understand the urgency which has accompanied this legislation since its introduction and therefore, suggest that consideration of this proposal be deferred until it can be carefully examined by all interested parties.

Currently, most corporate employees can look to three basic sources for post-retirement security: (1) Pension benefits; (2) Distributions from defined contribution plans; and (3) Social Security benefits.

Although we have not exhaustedly examined all aspects of H.R. 6410, INGAA notes several areas of particular concern to our members. First, we fear that this proposal will have the unintended effect of reducing the post-retirement benefits available to the rank-and-file employees, in addition to reducing the benefits available to employees who are highly compensated. Second, if rank-and-file employees are expected to rely more on social security, we seriously question the ability of our current social security system to "take on" the added burden of replacing the inevitable reduction in employer funded qualified plan benefits, which will result from this legislation. Third, we believe that in view of the existence of the Social Security Commission, which has been created to develop proposals for the restructuring of the social security system, it is premature to attempt to introduce new social security integration rules at this time. In view of the above, we offer the following general observations with respect to certain of the provisions contained in the proposed legislation.

LIMITATIONS ON CONTRIBUTIONS TO AND BENEFITS UNDER QUALIFIED PLANS

While the proponent of this legislation contends there is merit to a reduction in the current dollar limitations for defined benefits and defined contribution plans involving sole practitioners who have incorporated, we see no reason to apply this shotgun approach to all companies. In addition, we take exception to the 3-prong attack on maximum post-retirement benefits proposed by the bill. The concomitant imposition of (1) a reduction in the dollar limitations, (2) the elimination of the annual cost of living adjustment to these limitations, and (3) a reduction in the limitation for multiple plans from 1.4 to 1.0, will seriously impact the benefits which large corporations can offer to all of their employees.

H.R. 6410 will discriminate at inception against the top officials of most corporations. However, if the rate of inflation during the 1980's should even approach our experience during the 70's, the impact will extend to middle management and technical employees as well. This results from the fact that the bill does not provide for an adjustment for the dollar limitations for future changes in the cost of living index. It should be remembered that not too long ago Congress initially established the maximum annual benefit of $75,000 which could be paid by a defined benefit plan. Through the erosion of the value of the dollar, this maximum benefit has grown to $136,425.00. It appears inappropriate to permanently eliminate this cost of living adjustment for corporate employees while Congress is considering only a short deferral of the cost of living adjustment under Social Security. Moreover, we know of no proposal to remove cost of living adjustments from military, Congressional or from other government pension plans.

Furthermore, if this bill is adopted, it is quite possible that any significant reduction in qualified plan benefits payable to highly compensated employees will be equally experienced by the lower-paid employees. On the other hand, it may be that this reduction in benefits will be replaced by unfunded excess benefit plans available only to the highest compensated, thereby providing a result that is not in keeping with the goals of this legislation, i.e., to provide a safe reasonable retirement income for all employees. We do not believe that the additional reliance on supplemental non-qualified unfunded plans that will be forced upon large corporations (if they want to be competitive in order to retain key employees) is a proper approach to sound management. The retention of key employees is vital to the success of any corporation. The risk that a corporation will ultimately be unable to provide the promised unfunded supplemental plan benefit could very well deny those key employees to the companies most needing the highest caliber of talent.

The reduction in the limitation for multiple plans from 1.4 to 1.0 may also result in a substantial reduction in employee savings. Many companies encourage employee savings by matching (within the allowable limitations) employee contributions to savings plans. Under the proposed bill, these matching contributions can reduce the retirement benefits under a pension plan. Thus, it is likely that many savings plans and other defined contribution plans will be scaled down or eliminated.

While we recognize that abuse may arise under the current rules which allow a retiree to receive maximum benefits at age 55 without actuarial reduction, we believe that such abuses can be easily curtailed by providing that actuarial reduction will commence if retirement begins prior to age 62, rather than at age 65.

INGAA further believes that a reduction in the maximum pension limitation for post-retirement medical coverage is ill-advised. It can be reasonably anticipated that a significant number of employers will react to this proposal by eliminating or curtailing post-retirement medical coverage for all employees in order to maintain a level of pension benefits available only to certain of those employees.

INGAA suggests that the effect of this proposal will be contrary to a fundamental societal policy in this country, i.e., that the elderly will be assured adequate protection against medical expenses.

LOAN PROVISION

INGAA questions whether the provision which would place restrictions on loans made from qualified plans to the top 15 percent highly paid employees is reasonable. Because in most large corporations the top 15 percent will reach far beyond those in "control" or in a "policy-making position," treating the top 15 percent compensated employees as "key employees" would effectively deny loan benefits to many of those employees who most need them. For example, in many cases loans made from qualified plans are often the only means by which rank-and-file employees can fund their childrens' college education, or pay for other major family expenses. Therefore, it is recommended that the proposal which denies the benefits of loans from qualified plans to the 15 percent highest compensated employees be eliminated.

SOCIAL SECURITY

INGAA believes that in view of the bipartisan Social Security Commission established by the President, any attempt to introduce new Social Security integration rules is premature. INGAA believes that H.R. 6410 will impose a substantial additional burden upon the Social Security System which cannot be properly analyzed until the Commission has issued its report.

We appreciate this opportunity to make our views known to the Commission in its deliberation of the merits of these issues.

Respectively submitted,

JEROME J. MCGRATH, *President.*

STATEMENT OF DOUGLAS JOLLEY, PRESIDENT, DOUGLAS JOLLEY, INC.

1. INTRODUCTION AND PURPOSE

The sponsors of the Pension Equity Act of 1982 (designated as H.R. 6410 and hereinafter referred to as the "Bill") have expressly stated that their intent in proposing this legislation is to "provide greater equity in, and to prevent abuse of, the tax treatment of pensions". The purpose of this paper is to conclusively demonstrate that the Bill as presented will not only fail to accomplish either of these objectives, but will also provide a source of new and unconscionable inequities, deprive rank and file employees of essential pension benefits, and operate as a strong deterrent to economic recovery.

CENTER 2. AMENDMENTS AFFECTING CODE SECTION 415

2.01 Lower Dollar Limitations. The reduction in the dollar amounts contained in code sections 415(b)(1)(A) and 415(c)(1)(A) will not, as intended, reach only highly compensated employees, but will rather provide an across the board reduction in benefits. The following example is illustrative of this point:

A professional medical corporation employs one doctor (the sole director of the corporation) and two rank and file employees. The corporation maintains a discretionary non-integrated profit sharing plan covering all employees. The doctor's salary is $325,000, and the total of all salaries is $360,000. If the Bill is not enacted, the doctor who has total discretion in determining the amount of contributions to the corporation's profit sharing plan, will properly determine that the amount of such contribution is $50,372.31. Such amount will provide the doctor with the maximum allocation permitted under the law of $45,475, and the rank and file employees will recieve an allocation of the remainder which is $4,897.31. On the other hand, if the Bill is enacted, the doctor will simply determine that the amount of the profit sharing contribution is only $33,230.77 of which he will receive the maximum allocation permitted under the law of $30,000 while the rank and file employees receive $3,230.77. Thus the enactment of the Bill has not only reduced the allocation received by the doctor some 34 percent, but has also reduced the allocation received by the rank and file employees by the same 34 percent.

The above example illustrates how the proposed reduction in dollar limitations contained in the Bill operates to provide an across the board reduction in allocations under discretionary profit sharing plans. The same result will be achieved with respect to other type plans through the simple expediency of a plan amendment. The committee should also take note of the fact that although in the example all employees received an identical percentage reduction in allocation, the economic principle of marginal propensity to consume tells us that the burden of this pro-rata reduction is most heavily borne by the lower-paid rank and file employees.

In addition to the inequities associated with a reduction in the dollar limitations, the committee should also consider the economic impact of such reductions. It is clear that these reductions will seriously limit the influx of new capital into the private pension systems, and thereby immediately and severely restrict the ability of that system to continue to operate as a primary source of new investment capital at a time when the availability of such capital is so crucial to economic recovery.

In evaluating the merits of reducing the dollar limitations under section 415 of the code, we suggest that the committee carefully consider the following questions:

1. How does a provision that operates to cause a pro-rata reduction in contributions and benefits, and increases a burden which is most heavily borne by the lower paid rank and file employees, qualify as a provision which provides greater equity?
2. Will limiting pension contributions prolong or deepen the recession?
3. Is it possible that the Bill is not an equity measure at all, but rather a revenue measure only disguised as an equity bill?

2.02 Elimination of Cost of Living Adjustments. Cost of living adjustments are an essential part of any prudent retirement program. The Congress has stressed the importance of these adjustments in its own pension plan, the pension plan of many governmental agencies, and the social security system. By what rationale then, does Congress justify providing cost of living adjustments in its own pension plan, and then in the name of equity proposing that similar treatment be denied to the pension plans of the private sector?

2.03 Limitations on Contributions and Benefits Under Dissimilar Type Plans. The reduction in permissible plan fraction from 1.4 to 1.0 (under transition rules provided in the Bill) would essentially require that each employer phase out one type of plan. In viewing small employer plans, one will readily observe that by far the most common arrangement in such situations is the maintenance of a defined benefit pension plan with a plan fraction of 1.0, coupled with a money purchase pension plan with a plan fraction of 0.4. The advantage of this arrangement to the employer is that while there is a parity of benefits among participants in the defined benefit pension plan, the contributions to such plan generally are sharply in favor of the older more highly paid participants. The defined contribution plan, on the other hand, will provide a parity in contributions among participants, but will generally provide benefits which discriminate sharply in favor of the younger lower paid employees. In other words, the defined contribution plan is generally more favorable to rank and file employees, and the defined benefit plan is generally more favorable to the prohibited group. Now, in view of these facts, if the Bill is enacted and an employer is forced to "cutback" one plan, it should be obvious to the committee that the plan that is going to be reduced is the defined contribution plan since it is the plan that is least favorable to rank and file employees and most favorable to prohibited group members. This being the case, prohibited group members will suffer a small diminution in benefits under this provision of the Bill, and rank and file employees will similarly suffer a major diminution in benefits. The committee should inquire carefully into how this allocation of benefit reductions provides a greater equity in, or prevents an abuse of, the tax treatment of pensions in accordance with the stated objective of the Bill.

3. LOANS TO KEY EMPLOYEES

3.01 Conflict with Stated Objective. We must at all times bear in mind that a stated objective of the Bill is to provide greater equity in the tax treatment of pensions. How is it possible to provide greater equity by establishing a new category of employee known as "key employee" (defined in the Bill), and then expressly providing that loans to such employees, and only to such employees, will be treated for tax purposes as distributions from the plan? Obviously this provision of the Bill does not provide greater equity, but rather to the contrary establishes a new policy of discrimination against "key employees."

3.02 Actual Effect. Participant loan provisions are generally onerous in nature, and difficult to administer. Notwithstanding the usual desire of management to provide loans only to "key employees," existing law requires that if loans are to be offered at all, they must be made generally available to all participants. Under these circumstances, an employer must elect either to bear the burden of providing loans to all participants in order to obtain the right to provide loans to key employees, or to eliminate the participant loan provisions altogether. If this Bill is enacted, the choice will not be nearly so difficult. As a practical matter, loans will not be available to "key employees" anyway. Therefore there is no particular advantage to the employer in providing for participant loans, and these provisions will simply be eliminated from the plan. This is unfortunate, for two reasons: (1) Many rank and file employees do not have alternative sources of funds to which they may turn in time of need; and (2) The economy is likely to be deprived of much needed consumer purchases.

Before departing from this topic, it would no doubt be informative to examine just how the "key employee" is affected by the elimination of the participant loan provisions. The answer is virtually not at all. While such an employee probably has a stated preference for borrowing money from his pension plan in order to direct interest payments back to the plan, he does not receive a favorable rate of interest (under existing law loans from pension plans must bear a comparable rate of interest) and in all probability enjoys the distinct advantage of having many alternative sources of funds readily available to him. Under these facts, the committee may be, as we are, curious as to just how this provision of the Bill either "provides greater equity in" or "prevents abuse of" the tax treatment of pensions.

4. NONDISCRIMINATION COORDINATION

Unquestionably, the procedures for integrating private pension plans with certain public plans need reexamination. None-the-less, such as a reexamination would only be premature if conducted prior to the time of a final resolution of the entire social security problem. At this time, benefits under the social security system are far too tenuous to provide any sort of a basis for a meaningful discussion of integration procedures. Therefore, we would strongly urge that the only rational disposition of matters relating to social security integration, is a general deferral of consideration.

5. PLANS OF PERSONAL SERVICE CORPORATIONS

We find it incomprehensible, that the Bill which purports to "provide greater equity" by its express terms divides corporations which heretofore have been considered equal under the law into two separate and rather nondistinct classes, and then proceeds to provide one class with more favorable treatment than the others. It is our position that the gross inequity of this provision is so apparent on its face that further comment is neither needed nor deserved.

6. CONCLUSION

We have examined most of the salient provisions of the Bill. Our findings have shown that in terms of meeting its express objectives of providing greater equity and preventing abuse, the Bill is actually counter productive. Although we were unable to find a single inequity that the Bill eliminated, we were able to find several new inequities that it created. We have also pointed out enactment of the Bill would have an immediate and devastating impact upon economic recovery. The economy of this country, and the literally millions of rank and file employees who have worked, and indeed earned, the right to a meaningful pension, can not afford to have this bill enacted. We urge you to work for its early defeat.

SCHEDULE OF INDIVIDUALS AND ORGANIZATIONS REQUESTING THAT A POSITION PAPER RELATIVE TO H.R. 6410 BE SUBMITTED ON THEIR BEHALF BY DOUGLAS JOLLEY, INC.

Robert W. LaJoie
Wayne M. Schultz
Michael G. Ferguson
Michael B. Upton
Anthony J. Saladino
Peter A. McKay
Pat Rossi Accountancy Corp.
Synergistic Planning Corp.
MaryBeth Herbage
Diane L. Scheele
Janice Fronke
Elizabeth Stiles
Lila Moriarty
Newport Home Loan, Inc.
Steven C. Stiles
Alice Castner
Dorothy Dalzell
James P. Brophy
Paul Burge
Creative Micro Systems
Corono Del Mar Home Loan
Edith Parker
Don Jolley
Hazel Jolley
Bob Griffin
Jock A. Begg
Jack R. Barnes

FRANKLIN H. JONES & CO., INC.,
New Orleans, La., June 8, 1982.

Hon. JOHN SALMON,
Ways and Means Committee,
Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: Senators Dole and Long are sponsors of the Senate bill . . . . Rostenkowkski and Conable sponsor the House version and Congressman Rangel introduced "The Pension Equity Tax Act of 1982" (HR-6410).

We understand the House Ways and Means Committee will hold hearings beginning Tuesday, June 8 on HR-6410.

As proponents of a strong private pension system, we urge your opposition to these attempts to recover part of the tax reduction by selective imposition of additional taxes on a limited group of people. Such legislation would put considerable restraints on contributions to pension plans by closely-held businesses which will unquestionably result in cutting back retirement benefits not only for owner/employers, but for all their employees as well.

This is unfortunate because small business owners are becoming fed up with these constant attacks on qualified retirement laws. Results? Their employees will, in effect, be thrown into the Social Security system as their sole hope of achieving any kind of retirement income so the whole process is counter-productive.

Let's not forget that small businessmen and their employees, who are targets of these proposals, constitute 65 percent of the country's working population. Consequently, the social and economic results are tremendous.

Sincerely,

RICHARD L. MATHERS,
Vice President and Actuary.

KAISER ALUMINUM & CHEMICAL CORP.,
Oakland, Calif., June 18, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Kaiser Aluminum & Chemical Corporation strongly opposes the provisions of The Pension Equity Tax Act of 1982 (H.R. 6410) dealing with (1) overall limits on contributions and benefits (Section 2), and (2) integration with Social Security (Section 4).

I. OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

Kaiser Aluminum currently maintains a pension plan and a profit sharing plan for eligible salaried employees. We are now considering adding a salary reduction feature to the profit sharing plan, as permitted by IRC Section 401(k). The proposed maximum dollar limitations, the cutback of the 1.4 "two plant" limit to 1.0, the deletion of the cost-of-living feature and the reduction in the benefit limitation applicable to early retirees would subject a significant number of Kaiser Aluminum employees to the limits of IRC Section 415. This would prohibit such employees from utilizing the salary reduction feature and thus destroy their incentive to save. Since a large number of employees would not be able to fully participate in new qualified plan improvements, Kaiser Aluminum would be less likely to adopt other qualified plan improvements. By discouraging improvements in qualified plans, the bill would have the unintended effect of reducing retirement benefits for all employees including middle and lower-paid employees.

If H.R. 6410 were adopted in its present form, higher paid employees could continue to receive benefits not payable from the qualified plans from an unfunded non-qualified deferred compensation plan. In fact, benefits from such a non-qualified plan could be increased to compensate such employees for the fact that distributions from the non-qualified plan are not entitled to the same favorable tax treatment afforded to distributions from the qualified plans. The net result of this complicated, bifurcated pension structure, which many companies would adopt in reaction to the enactment of the bill, would be to substantially increase deductible employee benefits costs which would in turn reduce tax revenues.

The bill would substantially increase the administrative costs of maintaining qualified and non-qualified plans. We currently incur substantial actuarial costs in administering IRC Section 415 as a result of its complexity. The proposed additional limitations included in H.R. 6410 would substantially increase these actuarial costs. Another significant adverse effect of this provision would be to reduce contributions to qualified plans and thus erode one of our nation's largest source of investment capital.

II. INTEGRATION WITH SOCIAL SECURITY

Kaiser Aluminum currently maintains a pension plan which is integrated, under the offset method, with Social Security. The provisions of H.R. 6410 revising the Social Security integration rules are very complex. It is clear that the revised rules would significantly increase benefit and administrative costs on plan sponsors such as Kaiser Aluminum. There clearly has not been adequate time for interested persons to thoroughly consider such a far-reaching proposal. We feel that consideration of the proposed Social Security integration rules should be deferred until the National Commission on Social Security Reform has completed its study of Social Security and its relation to the private pension system. This would allow more time for the pension community to study the implications and impact of the proposed changes.

H.R. 6410 would have far-reaching impacts on the nation's private pension system. The full extent of such impact is unknown at this time. We believe the changes embodied in H.R. 6410 are so important to the health of the private pension system in the United States that a thorough study is required before any legislation is enacted.

It is imperative to strengthen not reduce the retirement benefits provided through the private sector. The more restrictions and complications placed on plans, the less appealing they become to employees and employers alike. We urge that H.R. 6410 not be enacted and that any major changes in the pension laws be deferred until they can be thoroughly evaluated.

We respectfully request that this letter be made a part of the permanent record of the hearings held on H.R. 6410.

Sincerely,

JOEL HASSEN,
General Attorney—Pensions.

TOPEKA, KANS., *June 3, 1982.*

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: Enclosed below are an original and five (5) copies of a statement expressing our unanimous opposition to H.R. 6410, the Pension "Equity" Tax Bill of 1982.

We are furnishing this written statement in lieu of making a personal appearance at the hearing respecting H.R. 6410 and hereby request that the enclosed written statement be filed for the printed record of the hearing on H.R. 6410.

(1) *Name.*—Executive Committee, Tax Section, Kansas Bar Association.

(2) We are writing as attorneys and members of the Executive Committee of the Tax Section of the Kansas Bar Association. We have not been requested, retained or paid by any person or entity to make this statement. This statement is our independent analysis of the weaknesses of H.R. 6410.

(3) *Outline of Recommendations.*—We oppose every aspect of H.R. 6410 for the following reasons:

(1) The effects of H.R. 6410 cannot be properly measured or even understood in the short period of time between the date of introduction of this Bill (May 19, 1982) and the scheduled date for hearings, Tuesday June 8, 1982. The issues posed by H.R. 6410 are so large in nature and so important to so many working Americans that they deserve very careful study. They should not be tacked onto the debt ceiling bill but rather deserve serious, lengthy deliberation. If the Bill were to become law, there would be a serious breach of trust with people who have relied on the ERISA pension scheme. The ERISA scheme was subject to intensive debate and carefully thought out, and provides a very reasonable answer to national pension policy. Most people are unaware of the Bill as the proposed law has received little publicity. Therefore, Congress will receive much more criticsm about this Bill as its contents become known and understood.

(2) *Unfair discrimination.*—The Bill unfairly discriminates against "personal service corporations", which are composed of lawyers, doctors, engineers, architects, accountants, actuaries, persons engaged in the performing arts, athletes and consultants, and their employees. The Bill proposes lower retirement plan limits for the preceding organizations than for other corporate entities.

What reason is there to let government contractors, large corporations, owners of gambling casinos, manufacturers, contractors, garbage companies, owners of bowling alleys, and any other corporate enterprises, have a better pension system than "personal service corporations"? The distinction cannot be one of wealth. There are very wealth businessmen and entrepreneurs who are incorporated and not engaged in personal service business, and who are exempt from this law as it pertains to personal service corporations. Recent publications (such as the National Law Journal and Medical Economics) show that the average income of lawyers and physicians is, respectively, approximately $50,000 per year and $65,000 per year. This is hardly a "fat cat" group which should be called upon to pay more than its fair share in tax revenues.

What sort of fair-minded tax policy is being furthered here? We submit that there is none. Why should the tax law discriminate invidously against these persons and organizations? The plan truth about H.R. 6410 is that some persons in political office are attempting to show, through this Bill, that they are not adverse to taxing the rich. In reality, this Bill will impose a severe burden on the middle class, small business, and working men and women involved in these business enterprises everywhere.

Let's be candid. This legislation has been promoted as a way to get a few wealthy physicians. Many surgeons who care for us are probably high earners. We hope that they have good retirement plans because they deserve it. Many work 6–7 days a week, under intense pressure, and for long hours. We submit that in a nation that purports to reward skill, ability, and success, some physicians deserve to be high earners just as much as the executive of any large corporation. We believe that they also deserve to be able to retire with pensions as liberal as any executive with similar earnings.

(3) The Bill will encourage bad tax shelter investments and produce less revenue for the U.S. government than the current pension law. There are, admittedly, some very wealthy professional people and athletes who have large retirement plans. While there are some high income earners in the professional group, such as Wall Street attorneys (who tend not to be incorporated in any event), heart surgeons, and a few other such examples, to change the whole scheme of the pension law because of a few wealthy individuals would be to throw the baby out with the bath. The few wealthy individuals who are contributing large sums to their corporate retirement plans, if this new law is passed, will simply hire sophisticated tax advisers to advise them with respect to tax-sheltered investments. Wealthy individuals have always been encouraged to invest by our tax laws in certain enterprises because they are believed to be in the public good. After the 1981 Tax Law, there are many real estate shelters, equipment leasing shelters, oil and gas shelters, as well as the more aggressive tax shelters such as "book deals", mining ventures, and so forth. These tax sheltered investement, due to tax losses and sometimes very poor investment performance, greatly diminish tax revenue. On the other hand, the current pension system encourage significant investments, and it only delays tax since the benefits paid from it are taxable. Thus, we submit that the present retirement plan system will provide more revenue than would a diminished retirement plan system, because the latter would foster more tax-sheltered investments of the type mentioned above. Even if some revenue enhancement would be achieved by H.R. 6410, which is doubful, H.R. 6410 is poor public policy. The benefits, if any, are not worth the cost.

(4) Rank-and-file employees will have their pensions cut at a time when Social Security offers little meaningful retirement assistance for those who are not presently retirement age. The present Social Security System is on the verge of bankruptcy. See U.S. News & World Report, June 7, 1982, page 35, which reports that every hour the Social Security System "loses one million dollars." Our elderly population is both growing and becoming less and less economically self-sufficient. There is a smaller ratio between those in the active work force, paying for Social Security benefits, and those who have retired and are on Social Security, depending on the current workers. In an era of inflation and rapidly rising health care costs, H.R. 6410 will undermine the private funding of pension plans at a time when they should be encouraged, not discouraged.

(5) The pension law has been amended several time in the form of statutory changes and regulation changes since 1974, when the Employees Retirement Income Security Act was passed. Further changes will cause elimination of plans due to operational, legal and accounting expense. Many changes have been made in the pension law since 1974 when ERISA was implemented. The basic purpose of ERISA was very good. We are not criticizing this. It is inevitable that some regulations must be adopted and changed and that plan amendments must occur. However, ERISA required plans to be amended by 1976, required additional amendments due to 1978 regulations, and IRS Notices 82-7 and 82-8, just issued last month, require all indivdual plans and prototype, basic, pattern and master plans to be amended in view of the change Congress made in 1980 to Internal Revenue Code Section 414 by adding Subsection 414 (m). Additional changes are an unbearable expense at this time to many small employers. They will cause the elimination of plans, which is to detriment of rank-and-file employees.

The Bill would also require 100% vesting for professional service organizations. This will also vastly increase the overhead of these plans., requiring short-term employees to be covered in the same way as loyal, long-term employees. This will unfairly increase the overhead costs for the employers and cause the elimination of many plans, which will deprive many people of retirement benefits they had counted on.

(6) H.R. 6410 is inappropriate at a time when government pensions have become fat and other government fringe benefits have become fatter. Congress exempts itself and other governmental employees from Social Security. Small businessmen must pay Social Security taxes for their employees without having any realistic expectation of benefits from this system as it is presently structured. Consequently, government employees are unfairly exempting themselves from the burden of providing for our aging population.

In addition, Congressmen and Senators last year voted themselves a $19,000 audit-proof income tax break at a time when, through H.R. 6410, they want to increase income taxes on other working Americans. There is also double-dipping and triple-dipping in the federal pension system. Many federal employees will retire with tremendous federal pension benefits (perhaps 2 or 3 such benefits) and then join the Social Security System for a short period of time and then get an additional Social Security benefit from private sector employment. The increasing disparity between the retirement security of government employees and the insecurity of middle class and small businessmen is another reason to reject H.R. 6410. If revenue enhancement is desired from pension reform, please also review governmental and big business pension rules before changing the rules on those in America's service professions.

(7) The current tax law favors large corporations and H.R. 6410 would make the tax law even more unfair. The 1981 Economic Recovery Tax Act represented a major victory for big business. Through a combination of qualified stock options, equipment leasing rules, fast depreciation write-offs, special investment tax credit incentives, and other "goodies", recent newspaper articles and economic studies have shown that many major corporations will pay little or no income tax. This means that they can provide preferential, discriminatory benefits for their executives while providing minimal or no benefits for the rank-and-file employees. There has been much recent publicity about this fact. Attached hereto as Exhibits 1, 2, and 3 are the following items which illustrate this point.

Exhibit 1.—This is an excerpt from a publication called "Deferred Compensation Arrangements" of Tax Management, Inc., a division of the Bureau of National Affairs, Inc., and is authored by Arthur H. Kroll, a New York City Wall Street attorney. The portion in column 2, circled, shows that ERISA exempts from virtually all of its requirements the "unfunded arrangement maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." In other words, there is a loophole in ERISA which allows

big business to provide discriminatory pensions for executives, while leaving out rank-and-file employees.

Exhibit 2.—A tax publication entitle Executive Compensation Employee Benefits Report, Volume 8, No. 8, April, 1982. Pages 1 and 2 feature an article entitled "How Wrap-around Pensions Can Attract Execs." See page 2 of Exhibit 2 indicating that "In any event, the increasing popularity of this type of arrangement, especially among large corporations, indicates a growing desire * * *". This recent article shows that since the large corporations have been saving a great deal of money in taxes, they can now accumulate money tax-free, or at low rates, reduce the current tax on executive salaries, and pay the money to them later when they will be in a lower tax bracket.

Exhibit 3.—An article from Corporation Law & Tax Report, Volume 15, No. 19, May 1, 1982, which on pages 2 and 3 also indicates that wrap-around pensions have become increasingly attractive for big business.

These wrap-around pensions and discriminatory pension arrangements are, as a practical matter, not utilized significantly by small and professional businesses. It seems unfair to encourage large business to have discriminatory pensions for the bosses and the ultra-rich executives, who make $300,000 to 1.5 million dollars per year, when the benefits of working Americans in personal service areas (areas where people help other people) would be sharply curtailed by H.R. 6410.

See also U.S. News & World Report, May 24, 1982, showing the very large salaries paid to big business executives which do not take into account their pension and stock option benefits. See also U.S. News & World Report, June 7, 1982, page 81, stating that 3 to 4 of "171 major firms" offer stock options to their chief executive officers and only 28 of these companies plan to offer stock options to other employees.

(8) H.R. 6410 will exacerbate the current shortage of investment capital. Pension funds are a major source of investment capital and recent articles indicate that they will be a major source of funding for home mortgages. A reduction in the private pension system will reduce the capital needed in the American economy.

(9) A high level of benefits for executive employees and professional and small business is necessary for high benefits for rank-and-file employees. Pension benefits for most organizations are structured for the executives. If they have large benefits, ERISA requires that the other employees be given proportionately comparable benefits. If the executives' benefits are diminished, the organizations will not generally maintain benefits for the rank-and-file employees at the same level. They will be reduced. H.R. 6410, if passed, would then put increasing pressure on the already collapsing Social Security System and public support network.

(10) Participant loans should not be eliminated for executives and shareholders as they provide good investments and a necessary safety valve for needed liquidity. Participant loans to all employees, including key employees, have frequently been one of the best investments pension and profit-sharing plans can make. They are almost always repaid and generate a high rate of interest, which is required by law. Internal Revenue Code 4975 and ERISA Section 408 require such loans to be repaid in full at a "reasonable rate of interest." This is generally interpreted to be a rate of interest at or near the prime rate of interest. If loans are eliminated, small businessmen will be less likely to adopt retirement plans at all because they will have no access to the funds in the event of a financial emergency. The assumption of H.R. 6410 is that these loans are somehow "bad." On the contrary, they are good because they encourage the establishment of ERISA plans and they provide excellent investments for the plans themselves.

If abuse in loans occur, the IRS, under current law, can disqualify the pension plans, impose a 100 percent penalty if the problem is not corrected, and tax the borrower. See Internal Revenue Code Section 4975, Treas. Reg. 1.401(a)-13, and Revenue Ruling 71-437, 1971-2 C.B. 185.

(11) H.R 6410, by eliminating inflationary increases in pension benefits, will result in inadequate pensions for persons presently entering the work force. An employee earning $30,000 per year at age 25, whose salary compounds at a 5 percent annual rate, will receive a pension benefit under H.R. 6410 of only 40 percent of his final pay. This would mean that a person making $30,000 in current dollars would receive a final pension of only $12,000 per year. For a more highly compensated employee, the pension would be even less as a percentage of his or her income.

If it is believed by Congress that corporate plans are better because they realistically keep up with inflation, then the remedy is not to eliminate indexing for inflation from corporate plans, but to add indexing for inflation to Keogh plans and individual retirement accounts.

(12) H.R. 6410 is a drastic change in public policy which itself will undermine faith in the tax law and the pension system in particular. Congress has been making rapid changes in the tax law during recent years. This "zig-zag" approach to public policy and tax planning erodes national confidence and makes our tax laws look like a game to the citizenry rather than a well thought out mechanism for raising needed revenue in a fair way. The adoption of H.R. 6410 will cause a massive tax revolt in the middle class, taking away the only valuable investment that many have had. Homes, which have been a nestegg of value for many people, cannot now necessarily be relied upon. The retirement plan is the one remaining economic security that should not be so drastically curtailed.

All members endorse this position paper and their names are listed on Exhibit 4, attached hereto.

Thank you for considering our views.

Respectfully submitted,

ALSON R. MARTIN, *Secretary.*

DETAILED ANALYSIS

corporation under the assumed deferred compensation agreements are normally capital expenditures (i.e., such assumption represents a part of the purchase price). 292/

J. Retirement Income Credit

In determining whether deferral of compensation will result in an overall tax savings to an employee, counsel should give due consideration to the effect, if any, of the retirement income credit 293/ and the additional personal exemptions which a person age 65 or over may enjoy. 294/

K. The Effect of ERISA

Employers and their advisers have been required to reexamine their nonqualified deferred compensation arrangements because of the broad provisions of ERISA and changes made by the Tax Reform Act of 1976. In the absence of a specific exemption, many of these types of arrangements could constitute "employee pension benefit plans" which would require full compliance with ERISA's rules including participation, vesting, funding, reporting and disclosure, and fiduciary standards.

An employee pension benefit plan is defined under ERISA as follows:

> "The terms 'employee pension benefit plan' and 'pension plan' mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program --
>
> (A) provides retirement income to employees, or
>
> (B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan." 295/

Thus, the first task of employers and their advisers is to examine their compensation arrangements to determine which of them could constitute plans, funds or programs falling within the reach of this definition. 296/ If the practices, employment contracts, resolutions or other documents constitute plans, funds or programs, and provide retirement income to employees or result in a deferral of income to employees for periods extending to the termination of covered employment or beyond, they could constitute employee pension benefit plans within the meaning of ERISA and, accordingly, would be subject to its burdensome requirements unless they qualify under an applicable exemption.

However, ERISA exempts from virtually all of its requirements, an unfunded arrangement maintained "primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." 297/ If the plan qualifies under this exemption, it will be exempt from the participation, vesting, benefit accrual, funding and fiduciary provisions of ERISA. 298/ An employer who maintains such a plan may satisfy the reporting requirements of Title I of ERISA with respect to such a plan by filing with the Department of Labor a single statement that includes the employer's name, address, identification number and a declaration that the employer maintains the plan primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, the number of such plans maintained by the employer and the number of employees in each plan. 299/ If requested to do so, the employer must also provide plan documents to the Labor Department. 300/ Thus, ERISA to the surprise of some employers, requires an identification of all such plans and a statement to be filed with the Labor Department with respect to them. In addition, although the question is far from clear, the plan may be subject to the requirement of providing a claims procedure. 301

As noted above, in order to qualify for this exemption, the plan must be unfunded and it must be for the benefit of a select group of management of highly compensated employees.

The question of what constitutes an unfunded plan therefore becomes very important. According to the Joint Explanatory Statement of the Conference Committee, 302/ "phantom" and "shadow" stock plans will qualify for this exemption. On the other hand, it may be that Labor Department regulations will provide that many informal arrangements will not be "unfunded" within the requirement of the exemption although they would be regarded as unfunded under traditional IRS tests. 303/ In this regard,

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292/ See M. Buten & Sons, Inc. v. Comr., 31 T.C.M. 178 (1972).

293/ §37.

294/ §151(c)(1).

295/ ERISA §3(2).

296/ For example, Labor Regs. §2510.3-2(c) provides that where bonus payments result in a systematic deferral of income to termination of covered employment, such a plan will constitute an employee pension benefit plan.

297/ ERISA §201(2). See DOL Advisory Opinions 75-63 and 75-64 (1975) (unfunded deferred compensation plans for "key" employees exempted from parts 2, 3 and 4 of Title I of ERISA).

298/ ERISA §§201(2), 301(a)(3) and 401(a)(1).

299/ Labor Regs. §2520.104-23. Statements were required to be filed on or before August 31, 1975, for plans in existence on May 4, 1975 and would presumably have to be amended within 120 days of establishing a new plan or discontinuing an existing plan.

300/ Ibid.

301/ ERISA §503.

302/ House Conference Rep. No. 1280, 93rd Cong., 2d Sess. 296 (1974). Reprinted in T.M., Primary Sources, Series 1, pp. 4975 [1974] 30-31.

303/ For example, the purchase of an annuity contract owned by the employer, would not constitute funding for IRS purposes, but

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Executive Compensation and Employee Benefits Report

by Arthur H. Kroll, Esq.

Volume 8, Number 8
April 1982

Executive Tax Planning

How Wraparound Pensions Can Attract Execs

Employers have found that the front-end or sign-on bonus can be an effective means of attracting executives. It helps make amends for benefits the executive has forfeited in leaving his previous job and offers him the chance to accumulate capital. Shareholders tend to question this device, however, because they feel that it does not provide sufficient incentive for the executive to remain with the corporation. Accordingly, companies are considering alternatives to this sensitive arrangement.

Wraparound pension program. One useful but often overlooked mechanism is the so-called wraparound or supplemental pension program, wherein the executive is guaranteed that he will receive pension payments in the form of a generous portion (usually 50 to 70 percent) of the average of his highest five years of compensation. These payments commence upon retirement and continue throughout the executive's lifetime and sometimes throughout the lifetime of his spouse as well. Thus, the employer agrees to pay from the general assets of the company the difference between the retirement benefits receivable under the company's qualified plans and the 50 to 70 percent of compensation guaranteed by the wraparound agreement. Often, this total pension package is indexed to reflect increases in the cost of living.

ALSO IN THIS ISSUE . . .

Lighten the Burden of Child Care Costs 2
Payroll Deduction IRAs—Are They Pension Plans? 3
Statutory Control Tests: Who Must Be Counted? 4
How to Conserve Thrift Plan Funds by Recycling 5
Pension Plans in Hostile Take-Overs: Another Chapter 5
Employment Law Update 7

Individual arrangements. The design of a wraparound agreement is flexible and can be tailored to suit the particular needs of the firm. For instance, in order to extend the incentive, the employer can establish that the benefit *rate* will depend on the length of the executive's service. Thus, a schedule might be set up to guarantee the executive that if he retires after four years of service he will receive 40 percent of compensation,

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Editorial supervision: Yale D. Tauber
Mr. Kroll and Mr. Tauber are members of the law firm of Patterson, Belknap, Webb & Tyler, New York.

EXHIBIT 2

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but that this percentage will rise proportionately with the duration of his employment, so that if he remains for 10 years he can expect a total package of 70 percent. In addition, the employer can specify the benefits around which the supplement is wrapped. For instance, the employer can establish that he will make up the difference between the guaranteed percentage and the sum of the executive's qualified plan benefits and Social Security benefits. Or the agreement can specify that benefits from qualified plans of the executive's former employers and a specific percentage, say 50 percent, of the executive's Social Security benefits will not be included in the offset amount.

● **Conclusion:** In any event, the increasing popularity of this type of arrangement, especially among large corporations, indicates a growing desire on the part of the employer not only to attract outsiders, but also to secure the company's "investment" in these top executives. If designed so as to offer the executive substantial security for retirement years and a powerful incentive to stay with the firm, a wraparound program should appeal to all parties concerned.

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CORPORATION LAW and TAX REPORT

Volume 15, Number 9 May 1, 1982

- **Enterprise Zones:** A capsule summary of the Administration's proposal. *(Page 1)*
- **Wraparound Pensions:** How to use them to attract—and hold—key execs. *(Page 2)*
- **Boards of Directors:** Here is an updated checklist of questions you should ask yourself *before* joining. *(Page 3)*
- **Incentive Compensation Plans:** They can insulate large salaries in a closely held corporation. *(Page 4)*
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- **Sherman Act:** Ninth Circuit allows fired employee to bring treble damage action against his employer for alleged Sherman Act violations. *(Page 6)*
- **Agency Law:** Its principles are used to determine whether there was a violation of the NLRA. *(Page 6)*
- **Employee Relations:** Fourth Circuit holds that giving up one job and its benefits to assume another was insufficient consideration for a lifetime employment contract. *(Page 7)*
- **OSHA:** Interpreting the "General Duty Clause." *(Page 8)*

Administration Proposal to Create Enterprise Zones Would Provide Substantial Tax Benefits

The Administration recently proposed the creation of an experimental free-market initiative to deal with economic problems in inner cities and rural towns. (Enterprise Zone Tax Bill of 1982.) Under the bill, certain areas would be established as "enterprise zones," based on criteria such as poverty, unemployment, and other indicators. Once an area is so designated, federal income tax incentives and regulatory relief would be available to employers establishing businesses within the zone.

Tax incentives proposed. Under the plan, the following tax incentives would be provided:

☐ A nonrefundable tax credit for capital investments can be pro-

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—From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers

EXHIBIT 3

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vided. For personal property as well as machinery and equipment, this credit would be 3 or 5 percent. Where construction or rehabilitation of commercial, industrial, or residential rental structures are involved, the credit would be 10 percent.

☐ A nonrefundable 10 percent income tax credit would be given to employers for a payroll paid to qualified zone employees in excess of the payroll paid to such employees in the year prior to zone designation.

☐ There would be a special nonrefundable 50 percent income tax credit available to employers for wages paid to zone employees who were disadvantaged individuals when hired.

☐ A nonrefundable 5 percent income tax credit would be given qualified zone employees for wages earned in zone employment.

☐ Capital gains taxes would be eliminated within these zones.

☐ Certain zones would also be designated as foreign trade zones, which would result in relief from tariff and import duties.

☐ Any enterprise zone firm would be permitted an operating loss carryover for the life of the zone in which it is located or 15 years, whichever is longer.

☐ Any enterprise zone firm would be permitted a carryover of any unused employment tax credits for the life of the zone in which it is located or 15 years, whichever is longer.

☐ Industrial development bonds would be available to small businesses in the zones, even if the availability of such bonds terminates elsewhere.

In the event the Administration's proposal is enacted into law, a maximum of 25 zones would be approved in each of the first three years of the program. Each zone would last for a maximum of 20 years plus a four-year phaseout.

CL&TR Note: CL&TR will keep you advised on the progress of this legislation.

How Wraparound Pensions Can Attract Execs

Corporations have found that the front-end or sign-on bonus can be an effective means of attracting executives. It helps make amends for benefits the executive has forfeited in leaving his previous job and offers him the chance to accumulate capital. Shareholders tend to question this device, however, because they feel that it does not provide sufficient incentive for the executive to remain with the corporation. Accordingly, companies are considering alternative arrangements.

Wraparound pension program. One useful but often overlooked mechanism is the so-called wraparound or supplemental pension program, wherein the executive is guaranteed that he will receive pension payments in the form of a generous portion (usually 50 to 70 percent) of the average of his highest five years of compensation. These payments commence upon retirement and continue throughout the executive's lifetime and sometimes throughout the lifetime of his spouse as well. Thus, the corporation agrees to pay from the general assets of the company the difference between the retirement benefits receivable under the company's qualified plans and the 50 to 70 percent of compensation guaranteed by the wraparound agreement. Often, this total pension package is indexed to reflect increases in the cost of living.

Individual arrangements. The design of a wraparound agreement is flexible and can be tailored to suit the particular needs of the firm. For instance, in order to extend the incentive, the employer can establish that the benefit *rate* will depend on the length of the executive's service. Thus, a schedule might be set up to guarantee the executive that if he retires after four years of service he will receive 40 percent of compensation, but that this percentage will rise proportionately with the duration of his employment, so that if he remains for 10 years he can expect a total package of 70 percent. In addition, the employer can specify the benefits around which the supplement is to be wrapped. For instance, the employer can establish that he will make up the difference between the guaranteed percentage and the sum of the executive's qualified plan benefits and Social Security benefits. Or the agreement can specify that benefits from qualified plans of the executive's former employers and a specific percentage, say 50 percent, of the executive's Social Security benefits will not be included in the offset amount.

CL&TR Note: In any event, the increasing popularity of this type of arrangement, especially among large corporations, indicates a growing desire not only to attract outstanding outsiders, but also to secure the company's "investment" in these top executives. If designed to offer the exec substantial security for retirement years and a powerful incentive to stay with the corporation, a wraparound program should appeal to all of the parties.

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STATEMENT OF WILLIAM A. BURNHAM, WILLIAM J. VESELY, JR., AND MARK D. WINCEK, KILPATRICK & CODY

Mr. Chairman, this statement is submitted by the law firm of Kilpatrick & Cody. Kilpatrick & Cody, based in Atlanta, Washington and London, is pension counsel to over 150 companies around the nation, from small businesses to very large corporations. Based on our experience in the employee benefits field, we are compelled to speak in opposition to H.R. 6410. While no doubt well intended, the "Pension Equity Act of 1982" will be both disruptive and detrimental to our largely successful system of providing retirement income and other deferred compensation. Moreover, H.R. 6410 is not a Robin Hood proposal, as it may at first appear. It does not take from the rich and give to the poor; it takes from everyone—rich and poor alike, and often disproportionately from the poor. In terms of our overall national policy, H.R. 6410 will, if enacted, have a tremendously damaging impact on the retirement income of a great many Americans; at the same time, it will further reduce our already inadequate national rate of savings. During a period when the social security system is under increasing strain and large federal deficits promise to be an ongoing problem, it is, quite frankly, an astonishing proposal.

Overall, H.R. 6410 will result in across-the-board retrenchment of qualified plan contributions and benefits, the replacement of plans which are subject to the minimum funding rules by discretionarily funded plans, greater reliance on non-qualified deferred compensation, a reduction in plan flexibility, and unjustified discrimination against providers of professional services. It is, in toto, an unfair and ill-advised proposal.

The following sections of this statement will review how these deleterious effects will occur by analyzing the specific provisions of the bill:

A. OVERALL LIMITS ON CONTRIBUTIONS AND BENEFITS

1. Defined contribution limit reduced to $30,000, defined benefit limit to $90,000

The limit on maximum contributions and benefits imposed by Section 415 directly limits the amount of income that may be deferred by highly compensated plan participants. However, because qualified plans are very frequently designed based on the Section 415 limits, reduction in the limits will indirectly, but inevitably, also reduce the deferrals for other plan participants. H.R. 6410 ignores the fact that it is the opportunity for tax deferrals by the highly paid that is the driving engine producing benefits for all. Reduction in the Section 415 limits will at the very least slow the rate of growth in rank-and-file plan benefits and, in a great many cases, result in a reduction in contributions and future benefits for these employees.

For example, in a typical non-integrated defined contribution plan, designed to provide maximum benefits for the most highly compensated participants, the approximately one-third reduction in the Section 415 limit contemplated by H.R. 6410 will produce an identical one-third reduction in the contributions made on behalf of lower paid participants, i.e., average participants will share in equal measure the effects of the Section 415 rollback. However, in the case of the more common integrated plan, because of how integration interacts with the Section 415 limits, reducing the Section 415 limit will produce a disproportionately larger reduction in contributions for average participants. These effects can be seen in Tables 1 and 2:

TABLE 1.—COMBINED MONEY PURCHASE PENSION AND PROFIT SHARING PLAN

[Nonintegrated [1]]

Participant	Compensation	Contribution 1	Contribution 2	Contribution 2 as a percent of contribution 1
A	$250,000	$45,475	$30,000	66
B	80,000	14,552	9,600	66
C	35,000	6,366	4,200	66
D	15,000	2,729	1,800	66

Note: Contribution 1—Present Law Sec. 415 limit; 18.19 percent combined contribution rate. Contribution 2—H.R. 6410 Sec. 415 limit; 12 percent combined contribution rate.

Table 1 reflects the magnitude of the contribution reductions that will be experienced by both upper and lower-pay participants in a non-integrated plan. To place the low-paid's reduction in perspective, it should be noted that participant D's account would be worth over $152,000 less after 30 years, if his employer contribution each year were $1,800 rather than $2,729.[2]

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[1] For simplicity, the current sec. 415 limit on annual additions to defined contribution plans is used. By 1983–84, when H.R. 6410 becomes effective, the increase in the sec. 415 limit by that time will cause H.R. 6410 to produce an even more dramatic reduction in contributions.

TABLE 2.—COMBINED MONEY PURCHASE PENSION AND PROFIT SHARING PLAN

[Integrated [3]]

Participant	Compensation	Contribution 1	Contribution 2	Contribution 2 as a percent of contribution 1
A	$250,000	$45,475	$30,000	66.0
B	80,000	13,012	8,410	64.6
C	35,000	4,417	2,695	61.0
D	15,000	1,815	1,095	60.3

Note: Contribution 1—Present law sec. 415 limit; present law integration (7 percent); contribution rate 12.1/19.1 percent. Contribution 2—H.R. 6410 sec. 415 limit; H.R. 6410 integration (5.4 percent); contribution rate 7.3/12.7 pecent.

Table 2 demonstrates how, in the case of an integrated plan, H.R. 6410 will place a relatively greater burden on low-paid participants than on the highly compensated. Because of the reduced Section 415 limit, Participant A will receive only 66 percent of his present-law contribution; however, Participant D will receive only 60.3 percent of such contribution. The effect of H.R. 6410 has been to give Participant A a greater share of total contributions made under the plan.

2. Aggregate defined contribution—defined benefit limit reduced from 1.4 to 1.0

H.R. 6410 also proposes to eliminate the so-called 1.4 rule, i.e., the rule that permits an individual to receive 100 percent of the Section 415 limit under one type of plan (defined contribution of defined benefit) and 40 percent of the limit under the other type plan. The intent of this change is, presumably, to reduce deferrals of income by high paid plan participants. However, it should be noted that while, under present law, the addition of another, different kind of plan will permit larger total deferrals of income by plan participants, it does not permit any additional integration. Consequently, when the first plan is fully integrated, a greater proportion of the contributions of benefits under the additional plan will go to low-paid participants than they receive under the first plan. Thus, elimination of the 1.4 rule exacerbates the disproportionately adverse impact that reduction of the Section 415 limits has on lower-paid participants.

This can be seen in the following example which adds a defined benefit plan to the integrated money purchase pension and profit sharing plan of Table 2:

TABLE 3.—INTEGRATED MONEY PURCHASE PENSION AND PROFIT SHARING PLAN (100 PERCENT OF SEC. 415 LIMIT)

[Defined benefit plan [4] (40 percent of Sec. 415 limit)]

	Contribution 1	Contribution 2	Projected benefit	Benefit cost	Sum (a) + (d)	(b) as a percentage of (e)
	(a)	(b)	(c)	(d)	(e)	
A	$45,475	$30,000	$54,575	$13,331	$58,806	51.0
B	13,012	8,410	17,464	4,269	17,281	48.7
C	4,417	2,695	7,641	1,866	6,283	42.9
D	1,815	1,095	3,275	800	2,615	41.9

Note: Contribution 1—(same as table 2) present law sec. 415 limit; present law integration (7 percent). Contribution 2—(same as table 2) H.R. 6410 sec. 415 limit; H.R. 6410 integration (5.4 percent).

The amount of income deferred for each participant under H.R. 6410 is set out in column (b). Column (e) sets out the amount of deferral which would occur under present law (the total of the contributions to the defined contribution plans and the amount necessary to fund the benefits under the defined benefit plan). Column (f) compares these two and indicates the percent of present law deferrals each participant would receive under H.R. 6410.

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[2] The calculation assumes a constant 10 percent interest rate. Since no inflation assumption is included to increase compensation and contributions, the differential after 30 years represents a "constant dollars" figure.

[3] Once again, for simplicity, the current social security wage base is used.

[4] To facilitate comparison, each participant is assumed to be the same age (40), no past service credit is given, and 5-year average compensation is equal to current compensation. Benefit cost is calculated using the entry age normal cost method; normal retirement age is 65.

As can be seen, the total deferrals for Participant A have been significantly reduced. However, once again, Participant D has lost a relatively greater portion of his present law deferral amounts. More significantly, however, the differential between the losses of Participant A and Participant D is even greater in Table 3 than it was in Table 2 (Table 3: 51.0 minus 41.9 equals 9.1 percent; Table 2: 66.0 minus 60.3 equals 5.7 percent). This reflects the fact that, in the case of an integrated plan, the low-paid participants receive a larger portion of the extra deferrals permitted by the 1.4 rule than they receive of those deferrals which do not exceed 1.0 times the individual defined benefit/defined contribution limits.

Thus, elimination of the 1.4 rule will affect not just high-paid participants, but instead participants from all income classes, and in the case of a great many integrated plans, it will take a larger percentage of deferrals away from low and moderate income participants. It should also be noted that elimination of the 1.4 rule will affect even individuals who participate only in a defined benefit plan. Voluntary contributions to a defined benefit plan may cause the Section 415 limits under H.R. 6410 to be violated, since they are treated under Treasury regulations as a separate defined contribution plan.

3. Elimination of the cost-of-living adjustment

Under present law, the Section 415 limits on maximum plan deferrals are adjusted annually for increases in the consumer price index ("CPI"). H.R. 6410 proposes to eliminate this adjustment and to cap the defined contribution and defined benefit limits at $30,000 and $90,000 indefinitely.

Recently, there has been considerable criticism directed at using the CPI as the basis for inflation adjustments in our federal benefit programs. Most prominent among these programs are social security and federal retirement benefits. This criticism has focused on whether the CPI is an appropriate basis for adjusting benefits under these programs to prevent their erosion by inflation. It has not generally been asserted that an inflation adjustment is itself undesirable or questionable.

In the private pension field, there has been considerable discussion as to the need for similar inflation protection of private pension benefits. Up until now, private pension and profit sharing plans have at least been able to ameliorate the effects of inflation by keying contributions or benefits to steadily rising compensation. H.R. 6410 threatens this partial solution. Failing to adjust the Section 415 limits on maximum deferrals for the effects of inflation will inevitably result in the wholly arbitrary degradation of private pension retirement income levels. Clearly, if how we adjust our retirement benefit programs for the effects of inflation deserves reconsideration and study, it should receive it. However, any change should be based on a thorough, careful review, and should be implemented uniformly in all areas of retirement income maintenance.

The current proposal is draconian and unreasonable. H.R. 6410's lower Section 415 limits and its elimination of their cost-of-living adjustment will, in a relatively short period of time, directly affect the qualified plan deferrals of even middle income taxpayers. Last year, the Ways and Means Committee sought to focus more of the 1981 tax cut on lower and middle income taxpayers, specifically those earning $50,000 and less. Assuming only a 6-percent inflation rate, it will take just 11 years for plan participants earning $50,000 to collide with H.R. 6410's truncated Section 415 limits.[5]

However, as noted above, because plan contributions and benefits are very frequently designed based on the Section 415 limits and the compensation of the highest-paid participants, the erosion of the Section 415 limitations by inflation will indirectly result in the reduction of benefits for all participants in such plans. In addition, in the case of an integrated plan, the effects will again fall more heavily on low-paid employees. This can be seen in the following example which shows what would happen under the Table 2 plan after 10 years of 6 percent annual inflation:

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[5] The example assumes participation in a defined benefit plan. At a 6- percent inflation rate, such participant will reach the limit for defined contribution plans in 15 years.

TABLE 4.—COMBINED MONEY PURCHASE PENSION AND PROFIT SHARING PLAN

[Integrated,[6] 1992]

Participant	Compensation [7]	Contribution 1 [8]	Contribution 2	(d) as a percent of (c)
(a)	(b)	(c)	(d)	(e)
A	$447,712	$81,450	$30,000	36.8
B	143,268	23,312	7,155	30.7
C	62,680	7,919	1,111	14.0
D	26,863	3,250	349	10.7

[6] Assuming that wages increase at the rate of inflation, the 1992 wage base, adjusted as provided in sec. 230 of the Social Security Act, is $57,900.

[7] Participant compensation is also assumed to increase at the rate of inflation.

[8] The 1992 sec. 415 limitation for defined contribution plans, adjusted for 6 percent inflation as provided in sec. 415(d)(1)(B), is $81,450.

Note: Contribution 1 (comparable to table 2) present law sec. 415 (adjusted for inflation as provided in sec. 415(d)(1)(B)); present law integration (7 percent). Contribution 2 (conparable to table 2) H.R. 6410 sec. 415; H.R. 6410 integration (6.2 percent—1992 OASDI tax on employers).

Column (c) lists the contributions that would occur under this plan under present law. Column (d) lists the contributions that would occur under H.R. 6410. Because of the adjustments which will occur in the rate of contributions (to reflect changes in the real dollar value of the Section 415 limit), H.R. 6410 will cause the contributions of all participants to be dramatically less than they would be under present law. For example, after 30 years, Participant D would have less than ¼ of his present-law account balance if the Section 415 limits of H.R. 6410 remain constant over the period—a differential of about $450,000.[9]

However, the more stunning condemnation of H.R. 6410's elimination of the inflation adjustment is the dramatic inequality of the reductions that it produces. As noted in Table 2, the interaction of integration with reduced Section 415 limitations causes a disproportionate reduction in contributions for lower-paid employees. Table 4 shows that as inflation continues to reduce the real value of the Section 415 limit, the magnitude of the disproportionate impact on low-paid employees increases significantly. In Table 2, the differential between Participants A and D was 5.7 percent; Participant A was left with 66 percent of his present-law benefit by H.R. 6410, while Participant D retained only 60.3 percent. In Table 4 the differential has grown to 26.1 percent. This differential would widen even further if the effects of H.R. 6410's elimination of the 1.4 rule were also taken into consideration in this example.

4. Other changes

H.R. 6410 also makes two other changes in the present-law Section 415 rules—the defined benefit plan limit would be actuarily reduced in the case of benefits payable before age 65, rather than age 55 or under present law, and the value of any post-retirement medical benefits provided under a plan would have to be taken into consideration in applying the defined benefit plan limit. The first of these constitutes a very significant reduction in the Section 415 limit applicable to defined benefit plans. Generally, it will reduce by about 30 percent the maximum benefit payable at age 55. Including the value of post-retirement medical benefits will not cause a comparably great reduction in the defined benefit Section 415 limit; however it will undoubtedly cause many plans now providing this additional benefit to eliminate it.[10] Elimination of this benefit would be felt strongly by lower-paid paticipants, the group for whom post-retirement medical benefits may be most essential.

In sum, H.R. 6410 proposes a radical alteration of the present rules limiting deferrals of income by plan participants. Cumulating all of the reductions in the Section 415 limits proposed by H.R. 6410, the bill will result in 1984 limits that are only about ¼ of present-law levels. [11] Since, as seen above, reductions in these limits can translate into even greater reductions in contributions and benefits for middle and low-income particpants, H.R. 6410 has the potential for being extremely far-reaching and regressive legislation. In addition, the proposal will create strong incentives to replace pension plans that promise participants a specific level of contributions or benefits with plans that allow discretionary contributions, providing less security for employees. It similarly contains powerful incentives for high-paid employees to rely on nonqualified plans of deferred compensation. Since such plans are often unfunded, this will combine with the overall reduction of qualified plan deferrals to further decrease our already depressed national rate of savings. Lastly, changes in the Section 415 limits will cause technical problems for provisions of the Code keyed to these limits, such as the speical Section 415 limit for Employee Stock Ownership plans (which applies only when no more than ⅓ of the plan contributions go to certain participants, including those earning more than twice the Section 415 defined contribution limit).

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[9] Assuming a constant 10 percent annual interest rate and contributions beginning at the level set out in table 2, after 30 years, participant D's account would contain $584,000, under present law, and $138,000 under H.R. 6410.

[10] Postretirement medical benefits can be easily eliminated since such benefits do not constitute an element of a participant's accrued benefit.

[11] The calculation assumes present-law sec. 415 limits of $51,100 and $153,300 in 1984, i.e., the current limits adjusted for 6 percent annual inflation.

B. LOANS TO PLAN PARTICIPANTS

H.R. 6410 proposes treating any loan by a qualified plan to individuals described as "key employees," or any loan under a Section 401(k) plan as a taxable distribution. Generally, this would extend the rule applicable to owner-employees who receive loans from H.R. 10 plans to corporate plans. Under present law, plan loans to any participant other than an owner-employee are not treated as a distribution as long as they have the characteristics of a bona fide arms-length indebtedness. Specifically, such loans must bear a reasonable rate of interest, must be adequately secured, and must provide for repayment within a reasonable period of time. In addition, such loans must be available on a basis which does not discriminate in favor of the so-called "prohibited group," i.e., officers, shareholders, and highly compensated employee.

The availability of loans from qualified plans adds important flexibility to programs for tax-qualified deferred compensation. It permits plan participants to develop retirement savings, confident that their accumulations could be temporarily available to them should the necessity arise. As indicated, the requirements of present law provide safeguards to ensure that any plan loan is a genuine indebtedness and not a disguised distribution. Problems with plan loans are best dealt with by fine-tuning of these present-law rules. However, H.R. 6410 does not purport to identify particular abuses. Its broad-brush approach is put forth without any justification.

This broad approach holds particular hazards. Plan loan provisions, because of the very specific requirements of present law, involve substantial administrative inconvenience. It is quite likely that a large number of plans will terminate loans for all participants, if the participants with the most leverage can no longer qualify for such loans. Since it is often plan participants of limited means who have the greatest need for the additional protection and flexibility that plan loans can provide, our tax policy should strive to maintain incentives to make plan loans broadly available.

A particularly undesirable aspect of H.R. 6410's proposed changes relating to qualified plans is its suggestion that all loans under a Section 401(k) "cash or deferred" arrangement should be treated as a plan distribution. Section 401(k) plans are only now being adopted by employers in large numbers. Overall, such plans hold the promise of significantly increasing the amounts that American employees save. However, research indicates that one of the major stumbling blocks facing Section 401(k) plans is the reluctance of rank-and-file employees to irrevocably tie-up their money until age 59½; the hardship exception does not appear to alleviate employee concerns because of its exceptionally narrow and uncertain definition. Including loan provisions in these plans does a great deal to assure employees that their funds can always be at least temporarily available, on a bona fide loan basis, without having to worry whether their circumstances meet the technical definition of a hardship.

Finally, this provision of H.R. 6410 repeats the increasing prevalent error of including a retroactive effective date. It is unreasonable that plan participants whose conduct is fully in accord with the law at the time it is undertaken should, nonetheless, be subject to the threat of penalty for such action by retroactive amendments. The unfairness of this approach is borne out by how frequently, just prior to ultimate passage of a provision, changes are made which ameliorate the harsher aspects of the proposal. Unfortunately, by that time, the proposal may already have had a chilling effect based on its original, uncompromised scope. Two situations we are presently dealing with exemplify the problem.

In the first, three individuals (key employees) have decided to invest in a new, innovative business. Because bank financing is simply not currently available for start-up enterprises, part of their investment was to come from a qualified plan loan. Prior to May 19, 1982, the plan administrator had reviewed and approved the loans, and all of the necessary documents had been drawn-up and executed; nonetheless, the funds themselves had not yet been transferred. In the second situation, the documents pertaining to an existing loan were to have been revised to clarify the terms of the original transaction. No extension or modification of the terms would be involved, merely a technical refinement to make clear that the loan did not constitute a prohibited transaction.

I would quite sincerely hope that neither of these situations would be covered by any loan provision that might eventually be enacted. Nonetheless, the retroactive effective date will require hard choices that should not have been imposed. In the first situation, for example, the business timetable does not allow the luxury of waiting more than a few weeks to see whether any ultimately passed provision will apply to loans that were 90 percent accomplished on May 19, 1982. I urge you to eliminate the retroactive effective date at the earliest opportunity.

C. INTEGRATION WITH SOCIAL SECURITY

Under present law, a qualified plan does not discriminate if it provides contributions or benefits that are an equal percent of pay when integrated, under rules published by the IRS, with Social Security. In the case of a defined contribution plan, H.R. 6410 would provide that plan contribution on wages up to the Social Security wage-base could be reduced by no more than an employer's actual contributions for Old Age and Survivors Disability Insurance (OASDI), i.e., for 1982-84, 5.4 percent. This compares to the 7-percent offset permitted under present IRS rules. In the case of a defined benefit plan, present law provides an employer with a choice of whether to offset the benefit payable under the plan by a portion of the primary insurance amount to which the employee is entitled under Social Security, generally not to exceed 83⅓ percent, or to provide a benefit reduced not more than 37½ percent on pay below a stated level, generally the compensation on which Social Security benefits are based. H.R. 6410 would replace these approaches to integration with (i) an offset based on the value, determined in accordance with Treasury regulations, of the OASDI taxes the employer pays with respect to the employee, or (ii) a "1-2-1 safeharbor."

The basic concept of Social Security integration is a highly equitable one. Social Security integration is intended to allow an employer to provide employees, both above and below the Social Security wage base, with a smooth rate of contributions or benefits. Thus, the theory of current integration rules is to roughly permit an employer to replace upon retirement the same portion of earnings for all his employees. However, current law no longer precisely achieves this result. Because of the failure to adjust current integration rules for changes in the Social Security program since 1971, the current rules result in a disproportionately great earnings replacement for lower-paid employees. The integration changes proposed by H.R. 6410 would further enlarge this disproportionate replacement. For certain income categories of employees, this would risk creating uneconomically large earnings replacement ratios, unless benefits are reduced for all plan participants. As the Ways and Means Committee noted in its most recent amendments to the Social Security Disability Program (Public Law 95-101), excessively large earnings replacements create substantial, undesirable work disincentives. The earnings replacement ratios that will likely result from H.R. 6410 may have a disruptive impact on our economy's ability to retain experienced workers and, consequently, productivity. Moreover, by encouraging early retirement, it will also increase the strain on our already troubled Social Security retirement funds.

In the case of defined contribution plan, H.R. 6410 would reduce the permissible offset to contributions below the wage base from 7 percent to 5.4 percent (in 1984). Unless an employer reduces contributions for all employees, this will increase the cost of maintaining a fully integrated defined contribution plan by about 23 percent of participant wages below the wage base. Presumably, the regulations contemplated by H.R. 6410 are intended to provide for a comparable increase in cost for defined benefit plans.[12] Because of the large number of fully integrated plans, the economic effect of this change will, unfortunately, approach that resulting from an increase in Social Security taxes. This is significant given the large body of economic research indicating that Social Security taxes, and comparable taxes on employment, strongly retard the growth of employment in our economy. In view of this fact, increasing employer cost by integration changes, at this time, seems particularly questionable.

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[12] However, applying a sufficiently large interest rate assumption to the Social Security taxes paid could actually increase integration offset applicable to some employees.

Moreover, the very premises on which the change is based seem arbitrary. Much of the differential noted above would disappear if the Hospital Insurance portion of the employer Social Security tax were included in calculating the employer Social Security contribution. Clearly, the Hospital Insurance tax, paid by an employer, funds an important element of his employees' total retirement benefits. Disregarding the Hospital Insurance tax is both arbitrary and inconsistent with the basic policies of integration. Indeed, it is highly ironical that H.R. 6410 treats post-retirement medical benefits as an integral part of retirement income, for purposes of the Section 415 limits, but chooses to disregard an employer's funding of such benefits for purposes of integration.

Thus, H.R. 6410's proposed integration changes go much too far and will have significantly undesirable consequences. Nonetheless, if some much more modest change is to be made, because of the economic shock effect that tightening the integration rules will have, any change should be phased in for all types of plans. The effective dates of H.R. 6410's integration provisions largely achieve this effect for defined benefit plans. A similar "cushioning of the blow" should be provided for employers who sponsor defined contribution plans.

D. RULES APPLICABLE TO PLANS COVERING THE SELF-EMPLOYED AND EMPLOYEES OF PROFESSIONAL SERVICE CORPORATIONS

Because of a series of favorable court decisions, professional service organizations have been able to extricate themselves from indefinite consignment to second class status in pension and profit sharing benefits. H.R. 6410 proposes to clamp down the lid once again, and to greatly broaden the application of the restrictive owner-employee rules, by imposing them on any plan covering a self-employed individual or a shareholder-employee of a professional service corporation. Clearly, if the special rules for owner-employees were ever justified, they lose all justification when so broadly applied. Having one set of deferred compensation rules for white-collar business entities, such as banks, insurance companies and the like, and a very different, much more restrictive set of rules for professional service organizations—both large and small alike—produces significantly different treatment for substantially similar organizations. In the same vein, it is difficult to see any justification for treating differently a small family business, and a professional service organization of comparable size.

Right now, it is probably an appropriate time to rethink the increasingly meaningless distinctions between corporate and H.R. 10 plans. However, reform of the current system should be done with an eye to solving real problems, and should avoid a scattershot approach that exacerbates, rather than corrects, the arbitrariness of our current multitier deferred compensation system. I look on H.R. 6410's proposal to unify the maximum contribution limits, applicable to H.R. 10 and corporate defined contribution plans, as a hopeful sign that genuine interest exists in better rationalizing the disparities of the current system. Unfortunately, out of apparent haste, H.R. 6410 has proposed solutions to the professional corporation issue which, considered overall, perpetuate past myths and do an inadequate job of addressing unnecessary inequities. I would hope that adequate time would be taken to appropriately study and debate this difficult area.

E. STATUTORY FRINGE BENEFIT PLANS

Section 7 of H.R. 6410 proposes to establish a single set of nondiscrimination rules which would replace those currently applicable to a number of statutory fringe benefits, and also apply to group-term life insurance and insured accident and health plans. Under present law, there are no nondiscrimination tests for accident and health plans, other than self-insured plans, and in the case of group-term life insurance meaningful discrimination provisions generally only apply with respect to programs covering fewer than ten employees. In addition, H.R. 6410 would limit the sanction for discrimination to those purportedly benefitting from the discrimination. To the extent they strive for a simplification of present law through uniformity, these represent commendable proposals. However, the application of administratively complex rules to group-term life insurance and accident and health plans will introduce a very significant administrative burden in areas where there is no evidence of a discrimination problem.

For purposes of the fringe benefit nondiscrimination rules, H.R. 6410 uses the same definition of "key employee" that it devised for purposes of the rules on loans from qualified plans, i.e., a key employee is an officer, 5 percent owner, or one of the highest paid 15 percent of all employees. In cases where an employer's fringe benefit program does not benefit 70 percent of its employees, it may be necessary for the employer to determine, in connection with a number of diverse programs, whether 85 percent of the participants in each program are not "key employees." In the case of fairly large employers, this will require a very substantial administrative effort. In the case of group-term insurance and accident and health plans, the most widely prevalent of the fringe benefits covered by Section 7, the resulting complexity will be the most acute and burdensome, while being the least necessary. These benefits should be eliminated from the scope of Section 7. With respect to the other benefits, I trust that any legislative history will indicate that past precedents relating to the "fair cross section" test will apply to Section 87(c)(2)(A)(iii) (with appropriate adjustment to reflect the definitional differences between "key employees" and the traditional prohibited group).

H.R. 6410 also provides that for purposes of determining whether or not a statutory fringe benefit plan discriminates, employees employed by affiliated employers (as determined under Section 414 (b), (c), or (m)) are to be treated as employed by a single employer. This rule promises to cause substantial difficulty for large employers who do not have unified fringe benefits programs among their various divisions and subsidiaries. Frequently, when a corporation acquires a subsidiary, it is undesirable to eliminate the distinct elements of that subsidiary's fringe benefits programs. Subject to some general test for the avoidance of the nondiscrimination rules, it would seem reasonable to permit the nonuniformity of statutory fringe benefits, other than deferred compensation plans, to continue. At the very least, some sort of grandfathering rule should be included, e.g., in the case of divisions or subsidiaries that were separately constituted as such on the enactment date of H.R. 6410, treatment as separate employers could, at the election of the taxpayer, continue for 5 years from the effective date of section 7 of H.R. 6410. Alternatively, the effective date of this provision could be delayed to permit further study.

F. ESTATE TAX EXCLUSION FOR RETIREMENT SAVINGS

H.R. 6410 also proposes to cap at $500,000 the amount of benefits under a qualified plan, IRA, tax-sheltered annuity or Federal retirement program that a decedent could pass to his beneficiaries free of estate tax. While this will, of course, reduce one of the present incentives for the accumulation of retirement income, it may be an appropriate suggestion in a period of extreme budgetary pressures. Nonetheless, the limit should be raised so that it would not apply to middle-income taxpayers. A current limit of $750,000 would be adequate to safeguard the retirement savings of a taxpayer presently making $50,000, who defers 15 percent of compensation (in current dollars) every year for 25 years.[13]

In addition, perhaps the chief problem with the proposal is its failure to provide for inflation indexation of the exclusion amount, in order to protect it from rapid erosion in the years ahead. An individual whose compensation is presently $50,000 will accumulate approximately $1,350,000, if he defers 15 percent of compensation for 25 years and his compensation rises at a 6-percent annual rate over the period.[14] An inflation adjustment will guarantee that an equivalent exclusion will apply to a decedent, no matter when he dies.

CONCLUSION

Congressman Rangel, when introducing H.R. 6410, repeated the well known words of President Kennedy: "A rising tide lifts all boats." Unfortunately, in a great many respects H.R. 6410 represents not a rising tide, but an ebb tide for pension and profit sharing plans. As noted, the kind of radical change proposed by H.R. 6410 will have an extremely broad impact and affect plan participants of all income categories. I urge that the implications of H.R. 6410 be much more carefully examined before we proceed, in order to avoid very serious damage to our highly successful system of deferred compensation.

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[13] The example assumes a constant interest rate of 10 percent.

[14] Ibid.

Lewis & Ellis, Inc.,
Consulting Actuaries,
June 4, 1982.

Committee on Ways and Means,
U.S. House of Representatives,
Washington, D.C.

Dear Committee Members: I am writing on behalf of Lewis & Ellis, Inc. to express opposition to H.R. 6410—the Pension Equity Tax Act of 1982. Lewis & Ellis is an actuarial consulting firm with six Enrolled Actuaries and 18 members of the American Academy of Actuaries on staff. We currently provide actuarial and administrative services for over 350 corporate pension plans.

H.R. 6410, as introduced on May 19, 1982 by Congressman Charles B. Rangel of New York, would have an extremely detrimental effect on the private pension system in this country. The proposed bill clearly discriminates against small businesses and will discourage such employers from providing pension benefits for their employees.

Under the bill, the current maximum benefit for a defined benefit plan would be reduced from $136,425 to $90,000, and future cost of living adjustments to this limit would be eliminated. When the Employees Retirement Income Security Act (ERISA) was enacted in 1974, the limit was set at $75,000 for 1975, with automatic annual cost of living adjustments. The proposed $90,000 limit is the equivalent of approximately $50,000 in 1975 dollars and its value will diminish rapidly at the current rate of inflation. The bill proposes similar reductions in maximum annual addition to a defined contribution plan.

One possible change that might be considered with regard to the automatic cost of living adjustments is to change the basis for adjustment to the same index as is used for adjusting Social Security benefits. This would result in comparability between the increase in benefits under private plans and the Social Security system.

The bill also provides a reduction in the maximum benefit under a defined benefit plan if retirement occurs before age 65. For example, if retirement were at age 55, the $90,000 limit would be reduced to approximately $40,000. There is nothing sacred or magical about a retirement age of 65 and many professionals, at whom this bill seems to be directed find it necessary to retire at an earlier age. These individuals should not be penalized for retirement prior to 65.

H.R. 6410 further reduces benefits for employees by reducing the maximum limits in situations where an employer sponsors both a defined benefit and a defined contribution plan. Currently such plans in combination can provide a ratio of 1.4 of the separate plan limits; this ratio would be cut to 1.0 by H.R. 6410. This would lead to the termination of existing plans (and reduced benefits to their participants) and to the discouragement of new plans.

The Keogh rules with respect to minimum participation and vesting standards, distribution limits and loan prohibitions would be extended to personal service corporations. This is obviously discriminatory and we see no justification for treating these types of corporations differently from other corporations.

Finally, the Social Security integration rules would be altered to such an extent that plans which attempt to recognize and compensate for the discrimination which exists in the Social Security formula, would not be allowed to do so sufficiently. The primary objective of any pension plan is to provide a level of benefits which, when supplemented by Social Security benefits, will be adequate to maintain the retired employee and his family on a standard of living which is reasonably consistent with that which they enjoyed prior to retirement. Plans would have to be redesigned and redrafted to meet the objectives of the employer under the new rules.

Coming so soon after the Pension Reform Act of 1974, which had tremendous impact in terms of plan revisions and costs on all plan sponsors, H.R. 6410 could be interpreted as a sign that current law cannot be relied upon for long-term planning. Many employers would, in our opinion, decide that the cost of complying with this bill and the uncertainties about future legislation would not be worth the reduced benefits derived from the plan. Those who would suffer the most would be the lower-paid plan participants, presumably the ones the bill is designed to help.

In conclusion, we feel that the proposed legislation unjustifiably discriminates against small businesses and personal service corporations and would be very detrimental to the private pension system in this country. We, therefore, oppose the passage of H.R. 6410.

Thank you for your consideration.
Respectfully submitted,

WILLIAM H. BLOUNT, M.A.A.A.,
Joint Board Enrollment No. 35.

STATEMENT OF PAUL LIEBERMAN, VICE PRESIDENT, BASSEY, SELESKO & COUZENS, P. C., SOUTHFIELD, MICH.

To the distinguished members of the Committee on Ways and Means: As the author of five volumes on the tax problems of non-publicly-held corporations in the new series being published by West Publishing Company, and with experience as a senior partner of one of the nation's largest tax-oriented law firms representing upwards of one thousand clients with qualified retirement and other benefit plans, I believe it would be in the best interests of this Committee, for the future of small businesses, and of their employees, to oppose certain aspects of H.R. 6410 because they violate one or more of the following four principles:

One, free enterprise should be fostered, not discouraged.

Two, people who honestly earn more should not be penalized.

Three, tax laws should not put out of business our system, which is largely voluntary, of providing health, disability, retirement and life insurance benefits for employees at all levels in small businesses.

And fourth, no particular group of workers should be singled out for negative tax treatment.

As a basic proposition, I agree with the goal of providing each citizen of this country with certain basic needs. which I would define to include health services, disability and retirement sums, and basic life insurance protection. At the same time, I believe in supporting and fortifying the free enterprise system. Those people who, are able to earn a significantly greater compensation than others should not be penalized for their efforts and achievements.

Our present economic tax system closely parallels my philosophy. Congress has enacted several social programs, including Social Security, Medicaid, Medicare, food stamps and Aid to Dependent Children, while, at the same time, through its tax laws, encouraging employers to establish pension, health, disability and insurance programs for their employees.

Probably the most dramatic proof that these tax laws have worked is that we do not have a nationalized health insurance system, as other industrial countries have.

My goal today, gentlemen, is to encourage you to continue a system which provides, health insurance, disability insurance, life insurance and pension benefits to millions of workers. Our firm alone represents more upwards of 1,000 companies with qualified plans. The "average" company has 25 employees and contributes $100,000 yearly to retirement funds and thousands of dollars more for other benefits.

Without these benefits, these employees or their beneficiaries would not be able to maintain a standard of living upon disability or retirement to which comes anywhere close to the standard of living which their hard years of work should have entitled them.

The problem, gentlemen, is that most American workers will not provide for his or her own needs out of his or her own pocket. This fact has led Congress to encourage small business employers to give these benefits to employees in addition to their basic compensation. And over the years, employees have grown to assume that they will continue to receive these benefits.

Unfortunately, it is also true that a large number of employees receiving these benefits are no longer giving small business employers any psychological praise, or economic credit, for the benefits the small business employers are paying for.

What, then, motivates employers to give employees these benefits? The clear answer, gentlemen, is that these benefits for both owners and employers alike are devised in a tax-favored manner. Realistically, if the benefits received are substantially greater than the cost of providing them, most, but not all, owners will grant the benefits. However, if the benefit received by the owners is relatively small in comparison to the cost of the benefit, few small business employers will grant the benefit to their employees, if given a choice.

Most employees expect some sort of health insurance is due them as part of their employment. However, it is our experience that they do not expect other particular benefits, and that the major, if not the only, motivation for granting the benefit is whether or not the owners of the business will grain substantially enough from the benefit to encourage them to grant it to other employees.

In addition, employers will shy away from the granting of any benefit which involves a large amount of government interference, reporting, or the possibility that the benefit which they expected will be denied them because of something over they have little control, such as a shift in the makeup of their work force causing them to not meet a rule against benefit discrimination.

Specifically, I must object on behalf of myself and our law firm's clients to the lower contribution and benefit limitations for qualified retirement plans, proposed by the Bill as an amendment to Section 415 of the Internal Revenue Code. The net effect of this proposal will be that higher paid employees, including the small business owner, will be denied their fair share of the retirement benefits provided by their small business.

Although it may seem entirely fair to prevent the person earning the princely sum of $90,000 from receiving a retirement benefit which will be based upon the amounts he or she earns in excess of such amount, the fact is that this will, in large measure, undermine the American dream. The Horatio Alger in all of us dreams of the day when our entrepreneurial spirit and drive will be remunerated by a large salary. Those of us who are willing to risk our capital, the hours we spend with our families, and all else to achieve this dream, are the ones who should be rewarded for making the private enterprise system of this country possible, for creating the jobs for the others of us who are not willing to pursue this dream so aggressively.

Every time we undermine or discourge or tax the attainment of that dream, we are destroying the will and desire of many people to obtain the fruits which the dream implies. Every entrepreneur knows that his or her dream may not come true until late in life. It is usually only at that time that he or she would have the resources necessary to provide for retirement.

This Bill destroys the ability to obtain the fruits of these labors in several ways.

First, because it does not provide for automatic cost of living increases in the contributions made to defined contribution plans, or in the pre-retirement benefits paid by defined benefit plans. Within a very short period of time, inflation will have prevented small business owners from obtaining a retirement benefit which is in excess of what even their middle management employees may be getting. What kind of incentive is this to pursue a dream?

Second, since small business owners can only expect to obtain their goals later in life, this Bill will destroy their ability to put away large sums of money in a defined contribution plan, because the contribution base will have been destroyed by the contribution limitation. Unless owners are willing to go into a defined benefit plan (which most employers are not willing to do, simply because of their fear that they will not be able to fund the plan every year), they will not be able to provide for their own retirement.

In fact, what they will be able to provide for themselves will be less than the amount which middle management or lower paid employees could provide if they had merely earned a "middle range" income over their entire working life.

Thus, small business owners who have postponed their income for a large number of years, will often be denied a retirement benefit which their own middle management employees have.

I am especially troubled by the fact that this Bill does not take into account that federal employees do not have their retirement benefits limited in any way, shape or form. Our understanding is that federal employees can continue to receive cost of living adjustments, merely by bargaining for the same, and are outside the constraints of this Bill. If our country's system is to have the respect of its taxpayers, it must deal fairly with all of its citizenry. In any case, the lawmakers should not discriminate for federal employees and against the general working population and the private sector which supports them.

I am also troubled by the proposed amendment of Internal Revenue Code § 415(b)(2)(C), regarding adjustments to benefits before age 55. Although the amendment is consistent with encouraging employees to retire at higher ages, present economic circumstances do not always permit employees to retire at higher ages.

Furthermore, most employees, especially entrepreneurs, run themselves down way before the age of 65. Thus, if an employee who has been especially productive but has had to retire earlier than age 65, for whatever reason is therefore denied full benefit, we have, again, stifled the entrepreneurial spirit as well as the ability of our economic system to reflect the particular need of its employees.

If it is your purpose to prevent employees from retiring at an early age from one business and then taking advantage of another qualified retirement plan by joining another business, this could be accomplished by forcing employees to take into account the benefits they received in their first position when calculating the maximum benefits they can receive in their second position.

As to the section which would immediately tax certain loans and other distributions made to employees out of qualified retirement plans, I would like to point out that, for upwards of 100 of our clients, this provision has been the salvation of their company during the past two years of economic distress. Because they could borrow from their plans, and thus reduce the compensation withdrawn from their companies in order to provide for their families, these small businesses have survived. This liquidity was the best investment this nation could have made under the circumstances. These loans did not benefit directly the employer, but benefited directly the employees who retained their jobs and the economy which retained the businesses whose future activities are our hope for future economic salvation.

It should be noted that I have not objected to the raising of the so-called Keogh limitations. I have not objected to this aspect of the Bill because I think it reflects the basic philosophy that no matter what form of business organization, one should generally be able to take advantage of the tax laws. Our present tax system makes tax distictions between proprietorships, partnerships, and corporations. However, if equal treatment of organizations and their employees is a goal of Congress, I would not object to raising the Keogh limitations.

What I do object to is the amendment to Section 41 of the Internal Revenue Code which extends the rules for self-employed plans to the plans of personal service corporations.

I also object to the growing propensity of some members of Congress to see certain groups of workers as sinister agents in our economic system. The group which they most often recently identified, by their words and actions, as undermining our country or as "fair game" is that of small business owners and professional employees of professional corporations.

It is bad enough Congress has chosen to discriminate in favor of certain municipal and federal employees by allowing them to establish retirement programs not generally available to the public. Moreover, Congress should stop discriminating against certain classes of individuals on the basis of the number of stockholders or percentage of ownership, such as the 10 or 5 percent provision in some retirement and other benefit plans. More critically, discrimination by classification against certain types of employment is counterproductive to our country's growth. Why should where professionals work make a difference as to what benefits they get under the law?

Why should it matter if attorneys, accountants, doctors, nurses, and other professionals work for the federal government, a large corporation, a small business, or for themselves under the "professional corporation" umbrella? Should it matter if physicians are employees of a hospital or own professional corporations? Should the choice of profession by particularly talented individuals be determined by what benefits they can receive under our laws?

Why should Congress get involved in determining or encouraging or discouraging individuals from going into a particular profession? If a particular attorney or doctor or engineer can be successful in that particular profession, why should that person be encouraged by our tax laws to become an executive of a corporation, such as, president of a hospital supply house or a real estate development corporation, simply because that is the only way tax laws will provide the retirement benefit which years of experience, entrepreneurial spirit, and status in the community calls for?

If we do not like the economic system which has created a demand for some types of professionals and, therefore, increased their remuneration, we merely have to encourage more people to join those professions and reduce that demand.

Other than providing for the exclusion on the rental value of minister's parsonages (IRC § 107) and mustering out payment to members of the armed forces (IRC § 113), Congress has not discouraged or encouraged people from going into a particular line of work.

Finally, I would like to comment on the Bill's proposal to add a provision entitled "Section 87, Benefits Provided to Key Employees under Certain Discriminatory Fringe Benefit Plans". I think that the goal of this Bill, which presumably is to even out the tax-free benefits payable to employees, whether or not they are key employees, is laudable. However, from my experience, I believe the effect of the Bill will be to take away those tax-free benefits which the large majority of lower paid employees are already receiving. Unfortunately, as I stated before, most employers will not pay for benefits when they don't see a major benefit for themselves and their companies. I am convinced that the net result is going to be the dropping of many medical insurance plans, disability plans, life insurance plans, and other beneficial programs.

What will Congress then do to replace these programs? If we are going to see the dropping of these benefits without their replacement, millions of workers who are too short-sighted or who cannot otherwise provide themselves with benefits will be denied the benefit at the very moment that they need it. The result will be untold numbers of individuals added to our welfare role unnecessarily. This is a direction which I, for one, would not advocate.

In all its aspects, except for the Keogh limit provision, the trade offs in H.R. 6410 will be disastrous to small businesses, their employees, and ultimately out country.

The advantage in some more tax dollars to the Treasury certainly does not outweigh the disadvantage of having to provide health insurance and other benefits for millions of people who did not receive them from their small business employers and stifling the small business owners and their spirit.

STATEMENT OF ALEX M. BRUCKER, ESQ., AND ANTHONY M. VIENNA, ESQ., TAXATION SECTION, LOS ANGELES COUNTY BAR ASSOCIATION

H.R. 6410, the "Pension Equity Act of 1982", was introduced by Rep. Charles Rangel on May 9, 1982. The Taxation Section of the Los Angeles County Bar Association (the "Section") hereby submits the following comments with respect to H.R. 6410, the "Pension Equity Act of 1982" ("H.R. 6410"), in the public interest on behalf of our membership, its clients and their employees. In connection with this submission, we provide the following procedural information: Los Angeles County Bar Association, 617 South Olive Street, Los Angeles, California 90014. Persons to contact: Alex M. Brucker, Esq., (213) 274-1152; Anthony M. Vienna, Esq., (213) 689-1400.

I. OVERVIEW

The Section opposes the enactment of H.R. 6410. In his introductory remarks, Rep. Charles Rangel stated, "A major objective of the bill is to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax subsidized pension and statutory fringe benefit plans." H.R. 6410 will not accomplish this stated objective because it provides for major disincentives to the continued growth and maintenance of a strong private retirement income system. If enacted, H.R. 6410 would have numerous negative effects which will be felt on a national scale. These negative effects may be broken into the three classifications set forth below:

1. Capital formation

The provisions of H.R 6410 will tend to discourage capital formation. Contributions to pension, profit sharing and stock bonus plans which meet the requirements for qualified status ("qualified plans") under the Internal Revenue Code of 1954, as amended (the "Code"), encourage savings and thus provide an important source of investment and venture capital for the United States. Qualified plan funds have been and continue to be invested in savings and loan associations, banks and insurance companies which provide capital for the real estate construction and financing industry, as well as the stocks of United States corporations. The continued encouragement of savings and capital formation is a declared policy of the "Retirement Income Incentives and Administrative Simplification Act of 1981 (H.R. 4330) as introduced by Rep. John Erlenborn (R-Ill.), hereinafter referred to as the "ERISA Incentives Act." This stands in stark contrast to H.R. 6410.

2. National retirement income policy

H.R. 6410, rather than strengthening the private pension system with additional incentives for employers to adopt and maintain qualified plans, removes those incentives and may indeed encourage the termination of many existing plans or the cutback of existing retirement benefits for all participants. With enactment of the Employee retirement Income Security Act of 1974 ("ERISA"), Congress took a major affirmative step toward strengthening the private retirement income system. The ERISA Incentives Act furthers this step by declaring as one of its policies "foster[ing] the growth and maintenance of employee benefits plans". Furthermore, retirement income benefits payable from qualified plans complement the Social Security System at a time when the financing of the Social Security System is experiencing serious problems.

This prior legislative policy has operated effectively to increase the role of private retirement plans in providing retirement income security for many employees. To the extent H.R. 6410 reduces the tax incentives for any group of employers to establish qualified plans, it is contrary to this policy which should continue as a favored policy by Congress. Moreover, there is no valid basis for denying those incentives to professionals as compared to other groups of taxpayers.

3. Financial and administrative burdens

H.R. 6410 will cause substantial financial and administrative burdens on the Internal Revenue Service and the sponsors of qualified plans. If enacted, H.R. 6410 will require that all qualified plans and trusts be amended and resubmitted to the Internal Revenue Service for new determination letters as to their continued qualified status. A similar administrative burden will occur when the ERISA Incentives Act is passed. This will place a double financial and administrative burden on the Internal Revenue Service and sponsors of qualified plans and is contrary to the policy of the ERISA Incentives Act, that is to reduce unnecessary burdens and costs associated with the maintenance of qualified plans. And, given the frustration level of some employers with the numerous prior waves of amendments required under ERISA, plan terminations may be a more likely result then plan compliance.

SECTION 2

H.R. 6410's proposed contribution and benefit reductions will dramatically alter the funding policies of many plans by reducing or eliminating future years' contributions. Furthermore, future plan costs may no longer be perceived as foreseeable or predictable because of continuing legislative changes in this area, which may result in the termination of many qualified plans. The Section believes that to the extent that revisions to Section 415 of the Code are perceived as necessary, they should be studied and incorporated into the ERISA Incentives Act, rather than enacted as separate, piecemeal legislation. A one-year freeze of Section 415(d) cost-of-living increases could be enacted in the interim if Congress chooses to limit the growth of private pensions while it studies the perceived problems.

The benefit reductions imposed by H.R. 6410 will be applied across the board to all types of qualified plans. As a consequence, H.R. 6410 will severely curtail the nation's private retirement income system by cutting back the present and future Section 415 benefit limitations, thereby reducing incentives for employers to adopt and maintain qualified plans for their employees. Unlike qualified plans which must comply with specific advance funding requirements, the Social Security system is awash in actuarial shortfall and financial problems. It is increasingly clear that the private retirement system must serve as a backstop to the Social Security System because major qualified plan benefits must continue to provide a substantial part of the income of retired employees and their spouses. H.R. 6410 will therefore, by reducing the benefit limitations for all employees, decrease the role of private pension plans in providing retirement benefits and correspondingly increase the burden on an already overburdened Social Security program.

Our Section has the following comments on specific provisions of Section 2:

(a) *Reduction to $90,000/$30,000 Limits.*—The $75,000/$25,000 amounts in Section 415 (b) and (c) of the Code were reasonable in 1974, and it is unclear to the Section why increases in those figures which have been merely commensurate with inflation have made them unreasonable.

(b) *Repeal of Cost-of-Living Adjustments.*—The Section believes strongly that the reasons for adjusting the old age and survivor's benefits under the Social Security System to reflect increases in the cost-of-living apply with equal force to the limits on contributions and benefits imposed on qualified plans. Since Social Security benefits continue to be adjusted for increases in the cost-of-living following an individual's retirement, it is particularly inappropriate to deny increases in the funding limits under Section 415 which have their greatest impact prior to retirement.

There have been proposals to limit the cost-of-living adjustments under the Social Security System, and it would seem appropriate to impose similar limitations on the cost-of-living adjustments under Section 415(d) of the Code, so that the adjustments made under the two systems would be equivalent. However, the elimination of cost-of-living increases for qualified plans alone not only would renounce the stated purpose of Section 415(d) "[t]o prevent the erosion of the value of an employee's pension due to inflation," H.R. REP. NO. 93-779, 93rd Cong. 2d Sess., 118 (1974), but would mandate an increasing reliance by all employees on the Social Security System to provide them retirement benefits.[1]

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[1] In this regard and particularly given the recent movements toward "parity", the Congress should consider provisions which would increase the limits applicable to Keogh Plans and plans of Subchapter S corporations automatically with increases in the cost-of-living.

(c) *Reduction of Multiple Plan Fraction to 1.0.*—The reduction of the miltiple plan fraction would (i) tend to discourage varying combinations of qualified plans which have led to greater benefits for employees; (ii) reduce flexibility in retirement planning, and in conjunction with the proposed reduction in the Section 415 limits and (iii) amount to a double cutback of retirement benefits. Furthermore, the change in the definition of "defined contribution fraction" will sharply reduce the extent to which a combination of qualified plans may be used to "make up" contributions or benefits for an older employee who was employed by the plan sponsor prior to the establishment of qualified plans. In addition, the reduction will cause many plan sponsors to terminate their defined contribution plans in order to continue maintaining their defined benefit plans, and this will operate to the detriment of younger employees.

(d) *Actuarially Adjusted Benefit Age Changed to 65.*—Under rulings in effect pre-ERISA, retirement prior to age 65 was the product of custom and practice in particular industries. In view of this history, the Section believes that this provision deserves further study.

SECTION 3

The Section understands that there are many qualified plans covering a broad spectrum of employees in which loan programs are available and provide a significant benefit to those participants who require access to their retirement funds for purposes of health, care, support, education, and residence purchases. Both ERISA and the Code presently provide that loans may be made to participants in qualified plans so long as they comply with the requirements of the prohibited transaction provisions of 408(b)(1) of ERISA and 4975(d)(1) of the Code. One such requirement is that loans to participants must be made available to all participants in a uniform and non-discriminatory manner. To the extent that Congress is concerned about loans to participants, the Section recommends that further study and consideration be undertaken, particularly with reference to regulation through the prohibited transaction provisions of Section 4975 of the Code.

Such prohibited transaction rules appear to offer a far better framework for addressing specific problems than the broadbrush blanket taxation solution offered by Section 3. The effect of treating a loan from a profit sharing plan as a distribution could be to disqualify the plan (adversely affecting all of the participants) under long-standing Internal Revenue Service rules that a profit sharing plan will not be qualified if employer contributions are distributed within two years of their contribution. At the least, Section 3 should provide that a plan loan constituting a deemed taxable distribution will not adversely affect the qualification of the plan.

Deferral of action on this Section is also recommended due to the arbitrariness of the May 19 effective date. Many employees have no doubt taken loans from plans after May 19, without notice of the proposed law. As amply illustrated by the recent spate of litigation regarding the retroactive effective date of the Multiemployer Pension Plan Amendments Act, such pre-enactment trigger dates create many more problems than they solve.

SECTION 4

Guidance to pension professionals on Social Security integration since 1971 largely has been provided by Rev. Rul. 71-446, 1971-2 C.B. 187, an extremely complex 12 page directive on the subject. Section 4 would introduce further complexity into the system by requiring that plans follow its requirements for employees commencing participation after 1983, while the standards in Rev. Rul. 71-446 continue to apply to preexisting participants. Given the great differences in the approaches allowed by Section 4 and Rev. Rul. 71-446, vast differences would resuld in the pension benefits available to employees who were similarly situated in all respects except date of hire. That is but one of the many disturbing aspects of Section 4.

Both the requirement of compliance with Section 4's new integration approach and the practical business necessity of somehow reationalizing the coexisting old and new systems would clearly require expensive actuarial and legal analyses for all or nearly all defined benefit plans. Due to the complexity of the area and the resulting likelihood that interpretative regulations or rulings would not be issued for years, such immediate plan revisions would probably also have to be followed by still further conforming plan amendments. The present and prospective expense involved in such revisions may cause many smaller employers, particularly in these difficult economic times, to elect to terminate their plans rather than incur further significant expense. Wholesale termination of plans is certainly inconsistent with the current national priority of private capital formation.

Under Section 4 of H.R. 6410, employers which decide to continue or to adopt defined benefit plans will be operating in a significantly different environment. Social Security integration currently allows defined benefit plans to be designed so as to offset a portion, but not all, of an employee's Social Security benefits against the benefits provided the employee under a plan. Section 4 changes the allowable offset to one calculated by reference to an assumed benefit based on the employer's Social Security contributions on behalf of the employee. This change substantially reduces the offset actuarially allowable for employees hired at higher ages and substantially increases the offset actuarially allowable for employees hired at lower ages. The result will be a strong incentive to favor younger employees in hiring decisions. In addition, windfalls will be available to older, higher paid executives in industries where the employee population is relatively young. Under Section 4, such employers may adopt defined benefit plans which would allocate a greatly disproportionate measure of plan contributions to purchasing benefits for such executives. Neither this scenario nor the above described disincentive to hire older employees fulfills H.R. 6410's stated objective of pension equity.

In sum, the significant practical and policy changes involved in Section 4 require a good deal more study before they should be seriously considered. Precipitous action in this complex area could have far-reaching and unintended ramifications.

SECTIONS 5 AND 6

The historical purpose of the proposals for parity was to eliminate complexities in the law resulting from distinctions in the tax treatment among different forms of doing business and different types of businesses. Instead of achieving parity as among different forms of doing business and different types of businesses, H.R. 6410 in fact expands the cumbersome Keogh restrictions to permanently discriminate against service businesses. The Section believes that there is no justification either in tax policy or equity for tax legislation such as H.R. 6410 which so distorts economic decisions.

Under present law such distortion results from complex restrictions upon owner-employee plans which (i) force the use of an institutional trustee, (ii) impose costly and administratively burdensome rules respecting rank-and-file employee participation, (iii) prevent effective offset of drastically increasing Social Security tax costs, (iv) discourage creation of effective defined benefit plans and (v) unnecessarily restrict distributions by comparison to corporate qualified plans. These factors severely discourage formation and maintenance of qualified plans for owners and employees of unincorporated businesses. However, such adverse effects are at least limited in that the alternative of incorportion exists, whereby the far more substantial and flexible qualified plans presently available to all incorporated businesses may be implemented so as to generate meaningful retirement savings for both business owners and rank-and-file employees.

H.R. 6410's proposals would extend owner-employee restrictions on a permanent basis not only to larger unincorporated businesses (not having 10 percent or more partners) but to all corporations providing specified personal services. The effects this will have are quite clear to practitioners who deal with these matters on a day-to-day basis. The formation and continuance of professional service businesses, which have been an expanding part of our economy and have provided many with new employment, will be to some degree discouraged. This can be illustrated by considering the fact that professional service providers such as lawyers and accountants will be able to receive superior retirement benefits by working for an industrial company. This obviously will adversely affect the practice of law and accountancy in independent firms, which the Section submits is not necessarily a desirable goal; it certainly distorts economic decisions. Furthermore, the broader imposition of the Keogh restrictions will discourage contributions to qualified plans, resulting in reduction of benefits for rank-and-file employees, increased dependence upon the Social Security System, and a reduction of the capital accumulation the country demonstrably needs.

It is recommended that a thorough study be made of the effect of expanding the applicability of Keogh plan restrictions. Affected employees could be motivated to divert amounts that would otherwise be contributed to the private pension system to alternative, less desirable forms of tax shelters. Rather than increasing contributions to Keogh plans, the new higher deduction limitations could thereby be viewed as a radical reduction in the incentive to save through qualified plans now offered to incorporated businesses.

It is further recommended that if H.R. 6410 is enacted in its current form a provision be added to allow personal service corporations to be liquidated without adverse tax consequences during a suitable transition period.

Two major points in the foregoing comments deserve further amplification:

(a) *Extension of Owner-Employee Restrictions.*—The owner-employee restrictions were ill-conceived in their inception, being apparently motivated by an obscure combination of paternalism and an assumption that small businessmen are less trustworthy than big businessmen. The Section is surprised that an extension of these rules, rather than their repeal, is being proposed. The Section believes that upon review, Congress would determine that Keogh plans subject to owner-employee restrictions simply do not tend to lead to meaningful retirement benefits for either proprietors or rank-and-file employees because of the disincentives referred to above. An example of the effect of their disincentives is the impact of the age 59½ distribution restriction. Usually a thirty year old businessman or professional is simply unwilling to commence more than a low level of retirement savings where he understands the funds will be restricted for 29 years. Where he conceives that he may be able to retire early (even though he is statistically unlikely to do so) his willingness to create savings for himself and his employees increases dramatically. As a result, most Keogh plan benefits are provided through plans maintained by larger firms without owner-employees.

(b) *Increase in Keogh Deduction Limits.*—The increase in Keogh limitations coupled with the extension of Keogh rules to service corporations is in effect a radical tax increase upon service businesses, since those able to save greater amounts have incorporated and will in many cases be cutback, rather than benefited, by the Keogh limit increases. As the Section understands H.R. 6410, the $90,000 defined benefit limitation under Section 415 will be further restricted by the equivalency to the $30,000 Keogh defined contribution deduction limit required by operation of Section 401(j). This will particularly impact older professionals who are reaching the point at which they are able and willing to save for retirement.

SECTION 7

In an effort to introduce anti-discrimination requirements into the fringe benefit area, H.R. 6410 would apply complex rules similar to those applicable to qualified plans. The addition of such requirements and complex rules is unwarranted. No valid evidence exists that discrimination has occurred in the statutory fringe benefit area to any material degree or that revenues are adversely affected. Above all, it is important to recognize that the statutory fringe benefits which would be affected by H.R. 6410 relate to important social issues of national concern. No legislation should seriously be considered before a careful study is made of the need for new rules and the potential impact of new rules on these important issues.

CONCLUSION

For the reasons stated above, we urge Congress not to enact H.R. 6410 in its proposed form and that the concern that Congress has raised by the provisions of H.R. 6410 be tabled and set aside for future analysis and discussion and be incorporated into and made a part of the ERISA Incentives Act sponsored by Representative Erlenborn. The issues presented by the provisions of H.R. 6410 have broad impact in the national economy and the national retirement income system, and therefore should be subject to further analysis and study.

Maccabees Mutual Life Insurance Co.,
Indianapolis, Ind., June 11, 1982.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: This letter states my opinion on H.R. 6410, the Pension Equity Tax Act of 1982. Five copies are provided for the printed record.

H.R. 6410, Section 2.—Decreasing permissible benefits and contributions in the private pension system while allowing benefits and contributions to escalate in the public pension system is contrary to the public interest. It is government saying: "We want you to do less for yourselves, but we will continue doing more for you."

Demanding defined benefit reductions before age 65 discourages early retirement. During periods of rising unemployment this would be a counterproductive idea.

Eliminating cost-of-living increases from the maximum benefit and contribution sections of the law fails to allow the private system to recognize inflation. Those who advocate "less government" would have the public system eliminate such increases while encouraging the private system to improve benefits.

H.R. 6410, Section 3.—Loan provisions in private pension plans are not consistent with allowing tax deductions for qualified "deferred" compensation. For stockholder employees the loan provision may provide a loophole for circumventing prohibited transaction rules. I support all restrictions of loan provisions.

H.R. 6410, Section 4.—Social Security offsets only allow the highly compensated the ability to partially reverse the discrimination in the public system. The combined public and private system retirement incomes of high-paid employees is a smaller percent of wages than it is for lower-paid employees. There is no need to discriminate further by reducing social security offsets.

H.R. 6410, Section 5.—I support increasing the Keogh plan dollar limitations to $30,000. The self-employed deserve more equitable treatment than is currently provided.

H.R. 6410, Section 6.—All employees of professional corporations deserve to be treated the same as all employees of other corporations. This section is inherently discriminatory and should be eliminated.

H.R. 6410, Section 7.—All efforts to prohibit discrimination should be encouraged.

H.R. 6410, Section 8.—Limiting estate tax exclusions for pension death benefits is reasonable. The contribution and accumulation of pension assets have received preferred tax treatment because of the social good provided to the elderly . . . not their younger descendents.

In summary, I believe that H.R. 6410 will do more harm than good for the private pension system. Changing the tax treatment of loan provisions and death benefits as well as improving Keogh limits should not create significant administrative expense for either plan administrators or governmental administrative agencies. Though sections 3, 5, 7 and 8 are generally well founded, the negative impact of H.R. 6410 is too significant for endorsement.

Sincerely,

DAVID J. MCINTIRE, CLU, FLMI,
Pension Investment Specialist.

STATEMENT OF THE MACHINERY AND ALLIED PRODUCTS INSTITUTE

The Machinery an Allied Products Institute (MAPI) is pleased to have this opportunity to present its views to the distinguished Committee on Ways and Means concerning H.R. 6410, the proposed "Pension Equity Tax Act of 1982," as introduced by the Honorable Charles B. Rangel, Chairman of the Subcommittee on Oversight.

MAPI'S INTEREST

As the Committee may know, MAPI is the national spokesman and economic research organization of manufacturers of capital goods and related products. Most of the Institute's member companies have qualified retirement plans, and MAPI has for many years participated in national policy dialogues dealing with both Social Security and private-sector plans, including the interrelationship of the two. We acknowledge that a financially sound Social Security system is an essential part of the socio-economic fabric of our society, and consider it equally essential to have a healthy, dynamic, private-plan participation. The two systems together—including private savings apart from those in qualified retirement plans—provide coverages and support that neither one alone could accomplish, and private pensions with their hundreds of billion of dollars of assets are the single most important source of new capital in the U.S. economy each year.

MAPI POSITION IN GENERAL

To summarize our general thoughts concerning H.R. 6410, we commend Chairman Rangel for catalyzing debate in this area, if only because such initiatives are the responsibility of the Oversight Subcommittee and qualified plans should be subjected to periodic scrutiny, including cost-effectiveness, benefit limits, nondiscrimination, suspected abuses, and other facets. However, we strongly protest treating H.R. 6410 primarily as a revenue enhancement measure and attempting to ramrod the bill to enactment as part of an expected Omnibus Reconciliation Tax Act or other vehicle for tax increases to mitigate the projected Fiscal Year 1983 deficit. In our judgment, the context (i.e., revenue considerations primarily) and the time frame chosen for evaluation of H.R. 6410 (i.e., the remaining few months to adjournment) are inappropriate. The issues addressed by the bill should be taken up—if at all—by the 98th Congress in a comprehensive review of the Employee Retirement Income Security Act (ERISA) of 1974.

More particularly, the Committee's preoccupation with revenues practically assures that inadequate attention will be given to capital formation, welfare, human resources, government operations, and other relevant policies, and we question whether Ways and Means should be the only committee with jurisdiction over the bill. There is a delicate balance between Social Security, the private retirement system, and other savings, and that balance cannot fail to be disturbed if tax benefits are curtailed for private pensions. We do not want to see significant policy established for private plans in a piecemeal review without reference to the total national retirement system. Similarly, we believe that the report of the Greenspan Commission pertaining to Social Security should be available to Congress before changes in the private sector's participation can be appropriately evaluated. Considering that ERISA required major commitments of time and resources by several Congresses, we cannot rationalize the Committee's attempting to revise the legislation on its own in a period of a few weeks.

Further, the Committee will recall that H.R. 6410 was introduced on May 19 and a one-day public hearing was called on short notice for June 8—subsequently changed to June 10. We question whether due process is served by truncated, "rapid fire" administrative procedures of this sort. Moreover, such procedures are particularly unfitting for the review of a subject as sensitive and complex as "pension tax equity."

Some points of agreement.—Before proceeding to specifics, we wish to state certain affirmative views that we have about matters taken up in H.R. 6410 although we oppose action on the bill at this time. For one, we agree that qualified plans should not discriminate in favor of officers, shareholders, and highly compensated employees. Also, we align ourselves with the view that there should be reasonable benefit limitations although we do not take exception to the ones now in place. We also consider it important that the administrative burdens to private plan sponsors and the International Revenue Service (IRS) be minimized. Finally, there should be more uniformity, to the extent feasible, in the rules and regulations applicable to various federally regulated retirment plans, and we agree generally that the plan restrictions applicable to different types of legal entities should not be significantly at variance with one another. We hasten to add that the above-mentioned objectives of equity, simplicity, and uniformity should not be pursued as "absolutes" because they are to some extent mutually exclusive.

Further, as already partly suggested, we feel that Congress should be moving toward the adoption of a coherent, conceptually sound, comprehensive, and consistent national retirement policy. The constituent parts of the retirement system and their respective roles should be well defined and understood before individual components are subject to revision. Furthermore, such revisions should be made in a total perspective that acknowledges and accounts for the integration and interdependence of the system's components.

IN MORE DETAIL

On matters of detail, we find in summary as follows:

(1) To our knowledge, no convincing reason has been given in support of lower dollar limitations for contributions and benefits, and we cannot support such changes based on seemingly idle assertions of some parties that the amounts appear to be "high."

(2) The cost-of-living adjustments (COLA's) applicable to dollar limitations of qualified plans may need refinement, but they should not be repealed. Consideration should be given to having uniform policy, to the extent feasible, for all retirement plan COLAs that are establshed by law.

(3) A reduction in the 1.4 restriction applicable to multiple plans, alone and/or in combination with other proposed limitations, could have harsh and arbitrary effects, and should be rejected, including the proposed change in computation of the thrift plan component.

(4) The proposals for mandated actuarial reductions are unnecessary, and could severely curtail those qualified plan benefits not already limited in this manner in the case of persons retiring under age 65 but having many years of service.

(5) The definition of "key employees" in connection with the treatment of loans from qualified plans as distributions should be narrowed, and we question whether such a rule should be entertained at all.

(6) The integration proposals would be an administrative morass and would produce confusing results in some cases.

(7) The proposed nondiscrimination tests for statutory fringe benefits are not feasible, as drafted, but we do not oppose the objective or more uniformity.

MAPI's more detailed comments concerning portions of H.R. 6410 are set forth below. Our omission of views regarding certain sections of the bill should not be construed as either approval, disapproval, or disinterest.

SPECIFIC COMMENTS ON H.R. 6410

Dollar limitations (Section 2(a))

The maximum dollar limitation on annual additions under defined contribution plans would be decreased from $45,475 to $30,000, and the maximum dollar limitation on annual benefits under defined benefit plans would be decreased from $136,425 to $90,000.

For existing plans, the provisions would apply to years ending after December 31, 1983; for plans not in existence on the date of enactment, the provisions would apply to years ending after that date.

Comment.—As already noted, we do not object to having dollar limitations at reasonable levels for contributions and benefits, but do not find anything unreasonable about the amounts now applicable under Code Section 415(b) and (c), to wit, the lesser of $45,575 or 25 percent of compensation and the lesser of $136,425 or 100 percent of average compensation for the high three years, respectively. Also, the dollar limitation proposal taken in conjunction with the proposed COLA repeal, actuarial reduction, and other new constraints—certain of which are taken up later in this statement—could scale down the maximum tax sheltered amounts to unrealistically low levels for most plan participants. If the Consumer Price Index (CPI), as now constituted or eventually to be revised, is an accurate indicator of loss of purchasing power, then the current dollar amounts are no more "generous" than the limits of $25,000 and $75,000 first set when ERISA was enacted. There may be perceptions that the limits have somehow become too high, but we submit that they have not changed in real terms and are as appropriate today as they were in 1974.

Along the same lines, if the objective of a private pension plan is to provide retired individuals with, say, a fixed percentage of final years' salary, why should tax-favored treatment apply in the lower- and middle-income ranges but be curtailed in the higher incomes where replacement ratios already tend to be less? Inasmuch as foregone revenues are the essence of tax qualification, the proposal to lower the limits would turn private plans more decidedly than at present into instruments of income redistribution. We question just how far Congress should venture this way in the context of "voluntary" plans? If private plan sponsorship, coverage, and benefits for the "rank and file"—in whose name the lower limits seem directed—were actually to be reduced as a consequence of the revision, how would Congress react? What are the implications for Social Security and other elements of the "social safety net"?

We do not intend here to project dire consequences as the fallout of a change in the dollar limitations that would be within reason, but the proposals do not even come close. Indeed, we suspect that highly compensated persons otherwise confined by the limitations would somehow manage to get along without significant change in their circumstances through nonqualified arrangements or other means, and would continue—albeit perhaps with less enthusiasm—within the bounds of their enterprises' resources to care for the retirement needs of those they supervise beyond the bedrock minimums provided by Social Security. Still, the Committee should not lose sight of the larger issues raised by the dollar-limitation provisions of H.R. 6410 and the pervasive effects of those limitations—coupled with others that have been proposed—for most plan participants. If, by piecemeal or wholesale revision, Congress enacts new tax disincentives applicable to the private-sector retirement system or skews the existing relief unevenly, the result could be very counterproductive, including the effects on revenues. Along those lines, we do not believe that the revenue estimates developed for H.R. 6410 are reliable because of the many imponderables, not the least being plan sponsors' responses to the legislation.

COLA (Section 2(b))

The dollar limitations for defined contribution plans and defined benefit plans would no longer be subject to automatic cost-of-living increases.

The effective date of this provision would be the same as would apply to the new dollar limitations, described earlier.

Comment.—In our opinion, the elimination of cost-of-living adjustments would be unwise because pensions involve long-term employer commitments and must take into consideration that compensation levels and commensurate retirement income needs will escalate in accordance with inflation as time goes by. Furthermore, Congress, as demonstrated in the past, probably would not make regular ad hoc changes in fixed-dollar amounts to reflect the declining general purchasing power of the currency. Even with the indexation scheduled to commence for certain federal income tax purposes in 1985—assuming that will come to pass—many provisions of the Internal Revenue Code remain unadjusted for and progressively diminished by inflation, a fate to which pension limitations certainly should not be consigned. We cannot support policy-change and tax increase resulting from inaction, and fully expect that this would take place in the absence of a COLA. If the existing adjustment mechanism does not work as intended, then it should be amended—not repealed. On an administrative point, the funding of defined benefit plans is facilitated by the use of COLAs, as compared to erratic, unpredictable adjustments made by Congress.

Uniformity and equity are other factors to be weighted, and neither purpose would be served by abolishing COLAs for private plan dollar limitations while continuing them in Social Security and congressional and federal employee retirement arrangements. Indeed, it may be useful in the near future to reconsider them all, taking into account the Greenspan Commission's recommendations as well as changes to be made presently in the CPI.

The 1.4 rule (Section 2(c))

For participants covered by both a defined contribution plan and a defined benefit plan of the same employer, the limit on the sum of the fractions of the separate limits used by each plan would be reduced from 1.4 to 1.0.

The effective date of this provision would be the same as would apply to the new dollar limitations, described earlier.

Comment.—For several reasons, we believe that the 1.4 rule should be left " as is" pending further study of its likely impacts. Some Committee members may recall that no such limitation existed prior to ERISA, and that a limitation of 1.0 was rejected by the ERISA Conference Committee. Therefore, this aspect of H.R. 6410 simply revisits an issue for which there already is a record. Although a limitation was deemed appropriate in 1974, an amount above 1.0 was chosen to encourage the continuation and growth of combination savings plans, including thrift plans that contribute to retirement income security but can be drawn upon for limited other purposes too. Clearly, a reduction in the existing 1.4 limitation would lesen the incentive for employers to sponsor both pension and thrift plans, and could affect savings adversely. Also, as Treasury has acknowledged, the limitation reduction could affect many rank-and-file employes and lead to the replacement of some defined benefit plans with unfunded excess benefit plans. Although Treasury proposed alternative approaches for insulating lower paid employees, there was no adequate discussion of either the rationale for discarding the 1.4 limitation or the extent to which national policy with respect to savings and investment would be inhibited by the proposed change.

Certain other difficulties we find with 1.0 have already been brought to the attention of the Committee by the Treasury Department. Specifically, Treasury pointed out that achieving a limitation of 100 percent of pre-retirement compensation would require "both complex transitional rules and complex plan amendments." The Committee should be reminded that the complexities of ERISA, notwithstanding the Act's overall merit, have resulted in a number of plan terminations since enactment and impeded the formation of untold numbers of plans by potential sponsors who have been repelled by the foreseeable administrative costs and burdens. Regulatory burden is not to be taken lightly in this context, and reinforces the case for an exhaustive reexamination of the proposal at a later date.

Finally, we object to the proposed change in the definition of the defined contribution fraction for purposes of the 1.4 limitation. Whereas the computation now is cumulative, the bill would cause the fraction to be the greater of the "annual fraction" or the "cumulative fraction," each phrase being defined. This is restrictive because the career-cumulative fraction customarily does not reach a high percentage due to the averaging effect of multiple years' contribution in relation to contribution limits. By comparison, an annual (i.e., current) fraction may run much higher. Assuming that a fairly high contribution might otherwise be made for a particular year, the lower limitation coupled with the higher fraction might require that the contribution be reduced or that the pension benefit be reduced to conform. Just as the reduction in the 1.4 limitation to 1.0 would lessen incentives to thrift plans, so too would the change in the contribution fraction itself be disadvantageous.

Actuarial reductions (Section 2(d))

If the retirement benefit under a defined benefit plan were to begin before age 65, the $90,000 limitation would be reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 65.

The effective date of this provision would be the same as would apply to the new dollar limitations, described earlier.

Comment.—The proposed actuarial reductions in benefits are not of concern to all plan sponsors because many existing arrangments already specify some such reductions for early retirement. However, we do not see why this should be required by law for plans that do not happen to "penalize" early retirement. Moreover, when taken in conjunction with the proposed lower benefit limits and the proposed 1.0 limitation for multiple plans, the actuarial reductions likely to be prescribed by IRS could leave an "early retiree" having, say, 30 to 35 years of continuous service with a relatively small amount of qualified benefits. Such an amount would be lowered still more by some—as yet unstated—value attributed to medical coverage provided to the retiree and his dependents.

Although we do not wish to overstate our concern about this portion of H.R. 6410, it would be yet another unnecessary restraint on private plans without actuarial reductions for early retirements, and we hardly think that H.R. 6410 should be the vehicle for establishing national policy with respect to early retirement. We note with interest that Chairman Rangel did not propose a similar restraint for Civil Service retirement, although the federal government's plan for civil servants is one of the more generous ones in existence. Even Treasury omitted reference to Civil Service in its formal statement to the Committee supporting mandated actuarial reductions. If the proposal is to be taken seriously, then one would think that federal retirement plans should be covered too.

Further as to Treasury's support, we do not agree that prohibiting maximum benefits for retirement at age 55 is the preferred way to deal with abuses involving th designation of artificially early retirement ages as a device to accelerate deductions. In our opinion, Congress should not eliminate deductions simply because some taxpayers abuse them, and Treasury might better sharpen the instruments of compliance and enforcement rather than curb tax benefits for all plans permitting early retirement without reduction. On the other hand, we do not object to the suggestion that Code Section 415 permit an actuarial increase in the maximum pension benefit payable to the individual who works past a given age.

Loans as distributions (Section 3)

Present-law loan rules applicable with respect to loans to self-employed individuals under H.R. 10 plans, qualified plans of Subchapter S corporations, Individual Retirement Accounts (IRAs) and accumulated deductible employee contributions would be extended to loans to (1) certain key employees under qualified plans, (2) tax sheltered annuities, and (3) qualified cash or deferred arrangements. If a key employee were to receive a loan from a qualified plan, or use an interest in the plan as security for a loan, the amount received or pledged would be treated as a distribution for income tax purposes.

"Key employees" generally would include employees (1) who are officers, (2) who have at least a five-percent ownership interest in the employer, or (3) who are among the highest paid 15 percent of the employer's employees. Also, any employee who elects to deter amounts pursuant to a qualified cash or deferred arrangement would be treated as a key employee with respect to amounts attributable to the elective deferrals. Further, any employee for whom an employer purchases a tax sheltered annuity contract would be considered a key employee with respect to the contract.

This provision would apply to loans, assigments, and pledges made after May 19, 1982. For this purpose, an existing loan which is renegotiated, extended, renewed, or revised after May 19, 1982, would be treated as being made after that date.

Comment.—We would be reluctant to see loans from qualified plans restricted as proposed, even though there is something to be said for moving in the direction of uniformity with H.R. 10 plans, IRAs, and qualified plans of Subchapter S corporations. We know of Treasury's allegations of "double-dipping" and "recycling" abuses, but they would seem to entail non-compliance with existing loan constrains and would involve breaches of fiduciary duty even if there were no restrictions. As the Committee probably is aware, loans already must bear a reasonable rate of interest; be adequately secured; provide a reasonable repayment schedule; and be made available on a basis that does not discriminate. If Code Section 4975(d) was sound policy at the time of enactment, we cannot accept that limited instances of abuse are justification for turning loans into distributions. Moreover, if the abuses are related almost exclusively to certain types of organizations—as we suspect—then the enforcement effort, or, if necessary, statutory revision, should be directed accordingly.

Of course, tax benefits enacted in furtherance of retirement security should not be redirected to purposes not intended by Congress. We feel, however, that loans of the type in discussion are unlikely in most instances to compromise the basic policy. The Committee is aware that most persons encounter periods of temporary financial strain, whether in connection with a home purchase, the education of children, or otherwise. Appropriately regulated loans, as compared to taxable distributions, do not defeat the retirement security purpose of tax qualification because the funds continue to earn interest while drawn down on arm's-length terms for other uses and eventually are returned to the trust. We think this should continue to be permitted, and would add that thrift plans and Code Section 401(k) cash or deferred arrangements will seem less desirable to persons of relatively modest discretionary income if the loan option were not available.

Regarding the definition of "key employees," it is much too broad. The top 15 percent of employees in terms of compensation often includes many individuals with no influence whatsoever over plan policy. To sweep in all Section 401(k) plan participants and tax-sheltered annuitants would be totally indiscriminate for the same reason.

Integration (Section 4)

An employee's annual pension benefit could be reduced by no more than an amount equal to the annual benefit which could be purchased with the aggregate Old Age, Survivors, and Disability Insurance (OASDI) taxes actually paid by the employer on behalf of the employee. Treasury would prescribe regulations for converting the aggregate Social Security taxes paid by an employer to an equivalent annual pension benefit, with compounding at an appropriate interest rate.

Under an alternative "safe harbor" rule for defined benefit pension plans, a plan would be considered to be properly integrated with Social Security if (1) the rate of contributions or benefits for pay in excess of $30,000 but less than $60,000 is not more than twice the rate for pay up to $30,000, and (2) the rate for pay in excess of $60,000 is not greater than the rate for pay up to $30,000. With the safe harbor, a plan could provide a simplified benefit formula which would not have to take into account actual OASDI taxes paid by the employer on behalf of individual employees.

For profit-sharing and other defined contribution plans, an employer could reduce plan contributions on behalf of an employee by no more than an amount equal to the employee's taxable wage base multiplied by the actual OASDI tax rate.

The new Social Security integration rules for defined contribution plans would apply to plan years ending after December 31, 1983. For defined benefit pension plans, the new rules would apply with respect to employees who become plan participants after December 31, 1983.

Comment.—The integration proposals epitomize the untimeliness of H.R. 6410 and the need to proceed more deliberately and circumspectly with revisions that would affect the overall national retirement system "equilibrium." Several reasons given for the integration proposals are (1) to simplify the rules; (2) to require that all participants in defined benefit plans receive some plan benefits; and (3) to allow each employer to integrate its plan only with respect to that employer's actual contribution under Social Security.

Inasmuch as the existing rules for plan integration are a forbidding thicket of "do's " and "don't's," we favor the objective of simplification. However, simplification would not be advanced by reverting from a system of integration predicated on overall plan formulas and rough approximations of employer-purchased benefits to one geared to individual accounts for each employee. Little would be accomplished by making the integration concept more comprehensible if implementation thereby would become vastly more burdensome. In the same vein, we note that the integration proposal would necessitate transitions from the existing practice to the new mode that would be both complicated and costly.

Simlification aside, we have some concern about the personnel relations implications of the proposed change. For example, as a result of the "grandfather" provision (which we support in principle), some employers undoubtly would find themselves with two classifications of employees for plan purposes. Also, the new approach to integration evidently would produce situations in which employees with long service could find themselves less well off in terms of plan benefits than those of short service because of the proportionately higher element of employer-paid Social Security in the accounts of the former. In addition to all the plans that would need amendment under the new integration scheme, employers would have to communicate and otherwise deal with discrepancies of the sort just mentioned that would not be readily understood by employees. Further, the change in benefits as a part of total compensation could affect agreements previously negotiated, including those collectively bargained and covering many employees.

Overshadowing the entire integration proposal is the fact that a bipartisam national commission on Social Security (i.e., the "Greenspan Commission") is scheduled to issue its report in December of this year. The Commission was established because the Administration and many in Congress believed they could unite more easily than otherewise would be possible behind the politically sensitive Social Security recommendations of an "independent" Commission. The report will address itself to the current and future role of Social Security including benefit levels and financing, and should serve as a rallying point for changes to shore up the program. Inasmuch as the Commission will, in effect, be initiating changes in the public system with which private retirement plans gererally integrate, we believe that action now on related features of H.R. 6410 would be premature.

Let us add that integration is complex because it defines the interrelationship of Social Security and private pensions, a subject that has been argued endlessly and has no easy or obvious solution. Indeed, in the past, integration has always been studied in depth and at length in connection with proposed revisions. We have no reason whatever to think that Chairman Rangel's approach would be "better" than the one now applicable, and his apparent predisposition toward reducing integration allowances sets him apart from the mainstream of independent experts who have dealt with this topic. By its very nature, integration is too important, complicated, and controversial a subject to be treated hurriedly, and the Rangel approach is sufficiently flawed on its face to warrant setting the matter aside.

We question whether the safe-harbor rule would be a suitably attractive alternative to the burdensome, individualized-account approach otherwise taken in the integration proposals. The safe harbor would appear to apply only to career-pay plans and we do not know the derivation or rationale of the dollar amounts or percentages. Without adjustment for inflation, most employees would soon be in the high accrual range and a plan that is in conformity could become too costly for many employers. If anything resembling the proposed integration approach is to be pursued by the Committee, we suggest that further attention be given to a safe-harbor rule that is more flexible and has a reasoned conceptual basis. However, we caution again that the subject does not lend itself to hasty deliberation.

Fringe benefits (Section 7)

New uniform nondiscrimination rules would be substituted for the separate ones now applicable to (1) self-insured medical reimbursement plans, (2) prepaid legal services plans, (3) van pooling plans, (4) educational systems programs, and (5) dependent care assistance programs. The new rules also would apply to employer-provided group-term life insurance, and to accident or health plans.

A statutory fringe benefit plan of the type just described would not be considered to discriminate in favor of key employees as to eligibility to participate if (1) the plan benefits at least 70 percent of all employees, (2) at least 85 percent of all participating employees are not key employees, or (3) the plan benefits employees who qualify under a classification set up by the employer and found by Treasury not to discriminate in favor of key employees. A plan would be discriminatory as to the benefits available under the plan unless all benefits available to participating key employees are also available to all other participating employees. However, a group-term life insurance plan would not be discriminatory merely because the amount of life insurance provided to employees had a uniform relationship to compensation.

In the case of a discriminatory plan, the portion of the employer's total cost for the plan year which is attributable to benefits provided with respect to key employees and is not otherwise includable in their gross income generally would be allocated pro rata among them for inclusion in gross income. Other reasonable allocation methods could be used subject to Treasury approval.

The foregoing rules relating to statutory fringe benefit plans would apply to plan years ending after December 31, 1983.

Comment.—As an abstract matter, we would applaud the goal of having uniform nondiscrimination rules, where feasible. However, we urge the Committee to consider carefully whether there is not some logic to the variations in provisions now in effect. Contrary to the implication of H.R. 6410, 'nondiscrimination" is, in fact, construed differently in different contexts, and reasonable minds differ in some measure as to what is discriminatory and what is not.

Also, the "equal benefits" part of the proposed nondiscrimination test is not defined and would be amenable to a host of conflicting interpretations depending on the statutory fringe benefit under examination. Indeed, we are not certain that "equal benefits" either should be defined in legislation or could be defined by Treasury without creating as much differentiation in the definitions of "nondiscrimination" as currently exists. For example, plans treated as nondiscriminatory under law now in force relate benefits to a variety of factors that are not the same from one employee to the next, and types and amounts of fringe benefits even differ among trades and locales. Some of the more innovative and flexible compensation arrangements would be straitjacketed by the proposal, and employers would have extra administrative burdens too. We cannot endorse such a proposal at ths time for the sake of uniformity.

We not further that "equal benefits" is not the customary concept underlying certain statutory fringe benefits—in addition to group-term life insurance—that are and probably should continue to be pay-related. For example, disability benefits have customarily been based on income maintenance in some magnitude. Finally, the "key employee" population would be defined too broadly, as in the case of loans to plan participants (discussed earlier).

CONCLUDING COMMENT

To conclude, we have seldom seen a bill under serious review by the Committee that is as untimely as H.R. 6410 or less likely to achieve its principal purposes. In our opinion, substantial portions of the bill are arbitrary, unadministrable, poorly thought out, and unfair. In spite of its ostensible concern about retirement security, H.R. 6410 seems to have potential for lessening the role of pension and thrift plans at approximately the same time that benefit reductions for Social Security will come under close scrutiny. The bill and the manner in which it is being handled also strike us as leaving much to be desired because of the fragmented approach, headlong consideration, and the primary focus on revenues to the exclusion of other national policy aspects. We sincerly hope that the Committee will leave H.R. 6410 out of the current budgetary debate and permit any such reevaluation of ERISA to be pursued methodically and comprehensively at a later date.

We thank the Committee for the opportunity to present these views and hope that they will be of use.

SANTA ROSA, CALIF., *June 1, 1982.*

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I wish to submit this letter as a written statement, in lieu of a personal appearance, on the above-captioned bill. I am making this statement in an individual capacity, and not at the request or in the employment of any of my clients.

From the information provided in your press release, it appears to me that this bill may be directed at curtailing the viability of a private pension system providing retirement benefits. At a time when the social security system is under a great financial strain and the number of individuals paying into that system for every individual receiving benefits is decreasing, it should appear that the system will not be able to provide the necessary retirement benefits that have come to be expected for individuals upon their retirement. Therefore, other methods must be looked to in order to provide those retirement benefits, one of which is private retirement plans.

Most of the employees in the United States are employed by relatively small employers. For these employers to adopt retirement plans, there has to be sufficient benefit to themselves along with flexibility in the plan provisions. I believe that the provisions to reduce the amount of annual contributions to the plan, to reduce the annual benefits for a general corporate plan, and to impose special limits on professional service corporations is a step in the wrong direction. A prohibition of loans to owner/employees has the general effect of prohibiting loans to anyone participating in a plan and restricts the flexibility of a plan, putting the employer in the position where he would have employees in financial need and the only way they could obtain the benefits would be to terminate their employment—a counter-productive move. If it were the owner/employee who had the financial need, we may very well see the counter-productive move of the termination of the plan.

It is my opinion that if changes are to be made in regard to private retirement plans, their general thrust should be to establish uniform rules for the plans of self-employed individuals and of corporations.

Your attention to my remarks is most appreciated.

Very truly yours,

ROBERT K. MAIZE, Jr.

THE MANITOWOC CO., INC.,
Manitowoc, Wis., June 18, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: The purpose of this letter is to enter into public record our comments on House Bill H.R. 6410.

The Manitowoc Company, Inc. is a Wisconsin corporation, with manufacturing facilities in Maniwotoc, Wisconsin and Sturgeon Bay, Wisconsin. A copy of our most recent annual report is enclosed.

Approximately 4,300 of our 4,450 employees participate in qualified, non-contributory, deferred profit sharing plans, which constitute the Company's only retirment program. Significant statistics regarding our profit sharing plan are as follows:

	Millions
Company contributions to employees' trust since inception in 1956	$63.3
Company contribution expected for current year	11.0
Current annual rate of benefit payments	3.8
Total assets currently in trust	73.5

We believe that twenty-six years of experience with deferred profit sharing plans qualify us to comment on the portions of H.R. 6410 dealing with defined contribution plans.

It is our understanding that two of the changes proposed by H.R. 6410 would decrease the maximum dollar limit on annual additions to individual participant accounts in a qualified defined contribution plan and would eliminate the automatic cost-of-living increases for this maximum dollar limit.

A report issued by the President's Commission on Pension Policy stated that although there is a need for some limitation on the total amount of income an individual could defer, government policies are needed to provide greater incentives to strengthen private sector retirement programs for all individuals. The proposed reduction in the maximum per-employee contribution would quite likely result in a deterioration in private sector retirement plans for all employees. The amount paid into a defined contribution plan and available for allocation to individual employee accounts is generally determined by a formula that requires a contribution equal to a certain percent of total payroll. If the dollar amount that can be allocated to highly paid employee's account decreases, many companies may decrease the formula contribution rate to a level that will just provide the maximum dollar limit for these employees. Such a decrease in the formula contribution rate will cause a proportional drop in the allocation amount for all employees.

The original 1974, $25,000 per-employee limit for defined contribution plans was presumably established in a rational and objective manner. The proposed 1984, $30,000 maximum dollar limit for these plans is equivalent to reducing that 1974 limit to $14,200 on a constant dollar basis. Unless there is evidence to show that the process used to determine the 1974 limit was faulty in some way, we do not believe it is appropriate to reduce the maximum dollar limit.

The report issued by the President's Commission on Pension Policy also stated that while Social Security, federal employee pensions, and military pensions are indexed to the Consumer Price Index (CPI), the impact of inflation on non-indexed forms of retirement income is devastating. During the period beginning in 1974 when the $25,000 defined contribution plan maximum dollar limit was first imposed by ERISA, through 1982 when this limit reached $45,475, the average annual CPI increase has been about 7.77 percent. The 1981 fiscal year median wage level of our approximately 4,500 employees was $16,261. If this median wage level is consistently increased by the 7.77 percent CPI rate of increase, a thirty year old employee earning $16,261 today would receive reduced contributions by age 65 because of the proposed $30,000 maximum dollar limit and elimination of the automatic cost-of-living increases. The H.R. 6410 proposal to eliminate the indexing of the maximum dollar limits effecty turns all private pension plans into non-indexed plans. We feel that this is not at all appropriate.

Another change proposed by H.R. 6410 would require loans granted to "key" employees (defined by H.R. 6410 as officers, 5 percent owners, and all employees among the highest paid 15 percent of all employees) to be treated as distributions for income tax purposes.

Table I below, which is derived from a review of our fiscal year 1981 wage information, provides income level and payroll classification information for the 643 fiscal year 1981 "key" employees of The Manitowoc Company, Inc.

TABLE I

Annual pay	Payroll classification			
	Salary exempt	Union	Nonunion hourly	Total
Above $130,000	0			0
$100,000 to $130,000	3			3
$90,000 to $100,000	2			2
$80,000 to $90,000	1			1
$70,000 to $80,000	2			2
$60,000 to $70,000	4			4
$50,000 to $60,000	5			5
$40,000 to $50,000	18			18
$35,000 to $40,000	25			25
$30,000 to $35,000	50	9	1	60
$25,000 to $30,000	109	25	9	143
$20,000 to $25,000	112	231	37	380
Total	331	265	47	643

In our experience, the loan provision in a qualified plan is used most frequently by lower income employees. Table 2 below shows how loans, granted to key employees during the last 23 months, were distributed by annual pay categories.

TABLE 2.—*Percent of "key" employees that received loans*

Annual pay:	
$40,000 to $50,000	9
$35,000 to $40,000	6
$30,000 to $35,000	9
$25,000 to $30,000	17
$20,000 to $25,000	59
Total	100

If the proposed H.R. 6410 "taxation of loan proceeds" change was implemented, it would effectively eliminate the benefits of loan provisions to many employees at relatively modest salary levels. While employers might readily make direct unsecured loans to small groups of high salaried employees, such as the seventeen employees shown in Table 1 in the above $50,000 wage level, employers are not likely to offer such loans to their entire "key" employee group as defined by H.R. 6410.

Current ERISA provisions prohibit discrimination in favor of highly paid employees when granting loans from qualified plans. These loan transactions can be reviewed during IRS audits to assure compliance with those ERISA provisions. We do not believe that such reverse discrimination treatment proposed by H.R. 6410 for qualified plan loans should be imposed by Federal law.

H.R. 6410 is likely to cause some existing plans to be terminated and to negatively affect the introduction of new plans. At a time when the viability of the Social Security system is doubtful, the strengthening of private sector retirement plans is very necessary. H.R. 6410 will only weaken these extremely important sources of retirement benefits. We strongly urge Congress to delay the passage of legislation such as H.R. 6410 until the implications of the proposed changes have been thoroughly studied by Congress and those private and government organizations that regularly work with such plans.

Very truly yours,

Allan L. Beyer, *Assistant Treasurer.*

Masco Corp.,
Taylor, Mich., June 18, 1982.

Hon. Daniel Rostenkowski,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

Dear Mr. Rostenkowski: We are writing to register opposition to the enactment of the "Rangel Bill" (H.R. 6410) which is currently pending.

In the face of increasing Social Security problems, this bill would detract from the private pension system and in this respect seems poorly conceived. In the context of Rational benefit planning it will seriously compromise and confuse ongoing efforts to compensate all employees fairly. Further, it is contrary to the thrust of the Economic Recovery Tax Act of 1981 which encouraged retirement savings and investments. In sum, we feel that the bill is deficient as providing potentially miniscule tax revenues and is clearly backward as an economic stimulus.

Masco companies presently sponsor more than 40 defined contribution and defined benefit retirement plans and would be significantly affected by this bill. Using conservative projections, we anticipate that in the near future, the bill's restrictive provisions would negatively impact a significant number of our supervisory, managerial and technical employees. Further, there would be substantial administrative expenses connected with the required plan amendments, and significant staff effort in communicating the changes to approximately 9,000 plan participants.

Again, we highlight our opposition to this bill and request further study of the area before any precipitant action is taken to enact this bill.

Very truly yours,

David G. Wesenberg,
Vice President, Human Resources.

Statement of McDermott, Will & Emery

INTRODUCTION

McDermott, Will & Emery ("MW&E") is a national law firm with offices in Chicago, Boston, Miami, Washington, D.C. and Springfield, Illinois. MW&E has had an active practice in the field of employee benefits since enactment of The Revenue Act of 1942. Currently, its employee benefits group (a part of the Employee Benefits and Employee Relations Department) consists of 20 attorneys and three paralegal assistants who work full-time in that field. The collective experience in the field of the 12 attorneys who currently are partners in the firm totals more than 196 years.

MW&E's clientele consists of employers who maintain in excess of 1,500 qualified pension, profit sharing, stock bonus or employees' stock ownership plans. Those plans cover from single or very few employees (not necessarily employed by professional service corporations as defined in H.R. 6410) to more than 300,000 employees of one controlled group of corporations.

PURPOSE OF STATEMENT

This statement is not submitted on behalf of any particular segment of the private pension universe, nor is it directed at any one feature of the Bill. It is not our purpose to plead the cause of professional service corporations, nor to plead the cause of any individual whose annual pension might be reduced from $136,425 per year to $90,000 per year. Instead, this statement is intended to point out, in broad terms, why MW&E believes the Bill should not be enacted into law. The time elapsed between the introduction of the Bill and its first exposure to the private pension system and the date set for hearings simply does not permit a detailed analysis of what may be either good or bad about each specific provision of the Bill.

SUMMARY OF REASONS IN OPPOSITION TO THE BILL

1. We believe that the long-range effect of the Bill, if enacted, would be to further weaken the private retirement system.

2. To the extent that the Bill would further weaken the private retirement system, it would correspondingly generate increased pressures for increased benefits under an already overburdened and underfunded Social Security System.

3. The Bill is inconsistent with prior Congressional actions with respect to qualified retirement plans and IRAs, some taken as recently as within the past 12 months, and is not supported by any significant estimated revenue recoupment.

4. If the Bill is intended to be a "Pension Equity Tax Act", then the Bill does not go nearly as far as it should go.

POINTS SUPPORTING REASONS FOR OPPOSITION TO THE BILL

1. We believe that the long-range effect of the Bill, if enacted, would be to further weaken the private retirement system.

Within the past eight years Congress has passed two important pieces of legislation which have impacted heavily upon the private pension system. The first, the Employee Retirement Income Security Act of 1974 ("ERISA") was the culmination of nearly ten years of hearings, studies and gathering of supporting data. In enacting ERISA, Congress recognized in its findings and declaration of policy the increased importance of the private pension system in our economy.

"The Congress finds that * * * the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment * * *." (Sec. 2(a), ERISA)

Concurrent with its enactment, sponsors and supporters of ERISA spoke glowingly of its intent to encourage and strengthen the private pension system.

The second piece of important recent legislation affecting the private pension universe was the Multiemployer Pension Plan Amendments Act of 1980 ("MEPPA"). Again, Congress stated its finding that

"* * * (3) the continued well-being and security of millions of employees, retirees and their dependents are directly affected by multiemployer pension plans; and (4)(A) withdrawals of continuing employers from a multiemployer pension plan frequently result in substantially increased funding obligations for employers who contributed to the plan, adversely affecting the plan, its participants and beneficiaries, and labor management relations; and * * *." (Sec. 3(a), MEPPA)

MEPPA was not enacted until eight years after the enactment of ERISA, and then only following extended hearings, gathering of supporting evidence, etc. Again, sponsors and supporters of MEPPA praised it as legislation designed to improve and strengthen the private pension system.

Other governmentally sponsored studies have reached similar conclusions about the importance of the private pension universe.

"Employee pension programs are crucial components of the U.S. retirement income system. Income from these programs provides a necessary supplement to the benefits provided by social security. Employee pension income is a form of indirect individual savings and, as such, is an important source of capital to the economy. These pension programs are less affected by demographic changes than social security." (Coming of Age: Toward A National Retirement Income Policy, Report of the President's Commission on Pension Policy, February 26, 1981)

Congressional actions designed to strengthen and improve the private pension system have resulted in just the reverse of the intended objectives. For example, following the enactment of ERISA, persons conversant with the private pension system predicted that where employers were completely free to act (e.g., not otherwise bound by a collective bargaining agreement) many defined benefit pension plans either would be terminated or converted to defined contribution plans.

In July of 1977, a scant 15 months after most of the provisions of ERISA became effective, the then Commissioner of Internal Revenue reported to a Subcommittee of this Committee that possibly as many as 30 percent of the private pension plans in existence when ERISA was enacted had been or would be, terminated in the wake fo ERISA. That report was based upon a preliminary survey conducted in four Regional Offices of the Internal Revenue Service. In April of 1979 the General Accounting Office indicated that ERISA was a major factor in the decision to terminate in the case of 41 percent of the plans that terminated between mid-1975 and mid-1977. That conclusion was based upon a study of ERISA's impact on small business which was conducted at the request of Congress. A desire to reduce or eliminate administrative costs and liabilities created by ERISA was cited most frequently as the reason for termination.

A study conducted by the Profit Sharing Research Foundation found that in the post-ERISA period from 1975 through 1981 a total of 92,615 qualified person, profit sharing and stock bonus plans were terminated. As of the end of 1974 there were 423,665 such plans. The results, which were based upon U.S. *Treasury Department* reports, confirm the fears of those who predicted that ERISA would cause a substantial number of plan terminations.

MEPPA is another example of the debilitating effect that recent Congressional actions have had on the private pension system. At present, there are estimated to be more than 100 suits on file in various United States District Courts throughout the country challenging the constitutionality of MEPPA. Employers did not wake up to the full impact of MEPPA until about nine months after its enactment when some employers began to receive demands for payment of withdrawal liability which exceeded their net worth. At this time Bills have been introduced in both chambers of Congress to mitigate the "overkill" effects of MEPPA.

At the same time, organized labor, which strongly supported MEPPA, is beginning to have second thoughts. Employers who heretofore have not been contributors to multiemployer plans are refusing to join such plans. Those who are contributing are seeking ways to get out. Employer trustees of such plans are balking at increases in the benefits provided under those plans, largely because of the already large withdrawal liabilities which MEPPA imposed upon employers who contribute to such plans. Meanwhile, management and organized labor representing employees in other industries are urging the Pension Benefit Guaranty Corporation to grant those industries an exception from withdrawal liability comparable to the construction industry exception contained in MEEPA.

If enacted, H.R. 6410 would pose for many employers the same questions they faced when ERISA and MEPPA were passed. Administrative costs will be increased, since practically every qualified plan will have to be amended once again. In that connection, the General Accounting Office study referred to earlier found that annual administrative cost of maintaining plans for smaller employers increased from an estimated $157,000,000 in the year before ERISA was passed to at least $710,000,000 in the year after its passage. The average administrative cost per plan was $1,753, $1,167 of which represented the cost of amending the plan simply to comply with ERISA. In the interim, employers have been faced with amending their plans intermittently in order to conform to final regulations periodically promulgated under ERISA. Not all of those regulations have been promulgated as of this date.

The portions of H.R. 6410 dealing with integration of private pension plans with Social Security will require employers either to reduce benefits, or, in the alternative, face significantly increased costs and liabilities. Preliminary indications to us are that where an employer does not choose to follow the "safe harbor" provisions of the Bill, the integration approach proposed by the Bill could reduce the presently permitted Social Security offset by as much as 80 percent. Applied to a large employer maintaining a defined benefit plan, the resulting cost increases could be disastrous.

If, as the facade on the National Archives Building proclaims, "Past is prologue", then it is reasonable to predict that H.R. 6410, if enacted, will result in termination of a significant number of qualified private pension plans, particularly among those maintained by employers of fewer than 100 persons. In other cases, benefits may be reduced significantly. The losers will be employees of those employers. The net effect will be to further weaken a private pension system which is trying to recover from, and cope with the effects of, ERISA and MEPPA.

2. To the extent that the Bill would further weaken the private retirement system, it would correspondingly generate increased pressures for increased benefits under an already overburdened and underfunded Social Security System.

If, as we believe to be the case, passage of H.R. 6410 will cause more terminations of private retirement plans, then the future security of persons covered by those plans will be weakened. The total retirement system in the United States has been compared to a "three-legged stool", one leg of which consists of the Social Security System, the second of which consists of the private pension system and the third of which consists of personal savings. Within the past seven years Congress has taken steps to lengthen and strengthen one of the legs (i.e., personal savings) through the creation of IRAs. A special Commission, appointed by the President and with bipartisan representation by Congress, is now exploring how to strengthen one of the other legs (i.e., Social Security) which is growing shorter and showing many signs of stress and strain. While this is going on, we believe that H.R. 6410 would weaken (or perhaps even saw off) the remaining leg (i.e., the private pension system). For a number of years now Congress has been tinkering with the three legs—with much the same effect as is produced when one tries either to trim or lengthen and strengthen one leg in order to produce a level and stable stool. One usually winds up ultimately adding or taking off too much from one leg, thereby requiring further adding or trimming of the other legs. It is respectfully suggested that the time has come for such actions to cease—at least until we find out with some *certainty* what is necessary to produce a balanced stool. Private pension plans are long-range undertakings. They are not entered into lightly, particularly since the enactment of ERISA. Legislation which "tinkers" with them and which has far-reaching effects should not be frequent or lightly considered.

The Social Security System leg of the stool is already too short, in that it promises more than it has the means to deliver. At some time within the next year Congress is going to face the unpleasant prospect of either reducing benefits under Social Security (or at least the rate of growth of benefits) or increasing taxes required to support it. Whatever solution to the short-term problems of Social Security is finally decided upon, if the result of enactment of H.R. 6410 is the termination of many more private plans or a freezing or reduction of the benefits provided by them, the inevitable result will be an increased demand for increased benefits under Social Security. It seems more logical to us that efforts should be directed away from increasing potential demands on Social Security and toward more reliance on the private sector. We believe that H.R. 6410 is traveling in the wrong direction.

3. The Bill is inconsistent with prior Congressional actions with respect to qualified retirement plans and IRAs, some taken as recently as within the past 12 months, and is not supported by any significant estimated revenue recoupment.

Within the past 12 months Congress took significant steps to increase the attractiveness of both qualified retirement plans and IRAs. The dollar limit on amounts which may be contributed by any individual to an IRA was increased to the lesser of $2,000, or an amount equal to 100 percent of taxable compensation. At the same time, the Code was amended to permit deductible voluntary employee contributions of a like amount if made to a qualified retirement plan. Further, Congress extended the privilege of either establishing an IRA or making a voluntary deductible contribution to persons who are covered by qualified retirement plans. All of this was designed to encourage voluntary savings for retirement (i.e., to encourage the strengthening of the third leg of the three-legged stool mentioned above). In The Revenue Act of 1978, Congress finally set at rest the status of so-called salary reduction or cash or deferred plans, proposed regulations governing which were not issued until late last Fall. A collateral objective of these actions, designed to encourage further provision for retirement by individuals, was to increase the rate of private savings in the United States which lags far behind the savings rate of other industrialized nations. The private pension system already consists of the biggest single pool of private capital. Congress has recognized for some years that this nation is "capital starved". Many of the actions taken in The Economic Recovery Tax Act of 1981 were designed to promote the creation of capital so as to enable modernization of our industries and thus be better equipped to compete with the rest of the world.

If enacted, the Bill would represent a long step backward from what Congress has done in recent years. Individual savings on a tax-deductible basis or on a non-tax basis, via a qualified plan, constitute probably the single most attractive means of savings for persons who are employed. For example, many private retirement plans already provide for voluntary contributions by employees. Some of those plans already have been amended to convert those contributions to deductible employee contributions. Other plans which require employee contributions have been converted to salary reduction plans. If those plans are terminated as the result of enactment of H.R. 6410, the only alternative for employees covered by such plans will be the establishment of IRAs. To the extent that they are terminated, the potential benefits of increased employee savings will be lost. Experience indicates that employees are more likely to save through the ease and convenience of some form of payroll deduction plan than to simply do it on their own.

In any case, in introducing the Bill, no revenue recoupment estimates have been furnished. We doubt that any significant amount of revenue recoupment, particularly in the context of a $700–800 billion budget, is involved. Balancing the potential harmful long-range effects of the Bill against what, at best, probably amounts to negligible revenue recoupment, leads us to a conclusion that the Bill should not be passed.

4. If the Bill is intended to be a "Pension Equity Tax Act", then the Bill does not go nearly as far as it should go.

Accepting for the moment the proposition that the Bill is not designed to recoup any significant revenue, and further accepting the premise that the Bill is designed simply to be a "Pension Equity Tax Act", then the Bill does not go nearly as far as it should go. Indexing of all entitlements, including Social Security, the Federal Civil Service System, military pensions, and even Congressional pensions, should be eliminated. This would only be a partial extension of what the bill would do to the private pension system in the name of "equity". In the latter case, not only is all indexing being eliminated, but the indexing which has occurred in connection with limitations, is being rolled back. Consideration also should be given to taxing at least one-half of Social Security benefits to the recipients, or, in the alternative, once an individual has collected Social Security benefits equal to his own contributions under the System, with interest, the entire amount of Social Security benefits should become taxable. After all, it is estimated that the average individual receiving Social Security benefits will get back approximately five times the amount of his contributions, with interest, in the form of benefit payments. Another form of "equity" would be to extend the treatment of professional service corporations contemplated by the Bill to all small businesses. Singling out certain professional service corporations for special restrictive treatment is a classic example of class legislation.

What we are suggesting would require considerable political courage. Yet, if equity is to be done, let it be done completely, or at least more completely than the Bill proposes.

We are not unmindful of the difficulties facing Congress in attempting to narrow the budget deficit, especially when it faces the difficult task of at least freezing and perhaps, in some cases, reducing existing entitlements. However, Congress should not lose sight of the fact that those who are recipients of entitlements are, indirectly, the beneficiaries of those who are employed and who are paying taxes. The efforts of the employed are supporting all existing entitlements. It is hardly equitable to reduce, or eliminate their incentives to save, so that at some future date they, too, may have to ask for entitlements.

CONCLUSION

While there are many additional reasons why H.R. 6410 should not be passed, we believe that the foregoing reasons, standing alone, are sufficient reasons to oppose it. the Bill is not designed to strengthen the private pension system or to encourage its growth. On the contrary, past experience indicates that the opposite is likely to be the result. The Bill does not alleviate the problems of Social Security. Instead, it is likely to create additional problems. Further, the Bill is inconsistent with other recent Congressional actions, and thus is a long backward step. Finally, rather than to create equity, the Bill compounds existing inequity. If an legislation similar to H.R. 6410 is to be seriously considered, then two weeks of exposure, coupled with a single day of hearings, is far too cavalier treatment of a subject of importance to nearly 50,000,000 people.

STATEMENT OF W. DEAN HOPKINS, MCDONALD, HOPKINS & HARDY CO., CLEVELAND, OHIO

Mr. Chairman, I am W. Dean Hopkins, a member of the Cleveland, Ohio law firm of McDonald, Hopkins & Hardy Co., L.P.A. (a professional corporation since 1970). Our firm represents more than 400 closely held corporations that have qualified retirement plans.

Most of the employees of these corporations will have their retirement benefits reduced or eliminated if HB-6410 is enacted. This should lead us to ask—What policy would be advanced by this bill? Regardless of intent, the result would be to discourage private retirement plans and to reduce benefits for employees at all levels of compensation.

Let me give one example. A corporation that would be affected is a manufacturing company that began business in Ohio in 1816 and was incorporated in 1885. This corporation which we represent is owned and managed by the sixth generation of the family that founded it. The proposed dollar limitation would reduce the percentage of compensation of executives that can be contributed to that company's retirement plans, and that same reduced percentage would then be used for the rank and file employees as well. The proposed legislation would thus reduce retirement benefits for more than 40 employees, only one of whom is a stockholder. This pattern would occur in many family-owned corporations.

I leave the detailed analysis of the Bill's shortcomings to others, but let's face the fundamental issue squarely. This kind of legislation has been promoted as a way to limit retirement benefits for a few rich doctors. I speak to this point with special experience as I had openheart sugery five years ago. The surgeon who cared for me has probably been a high earner. I hope that he has a good retirement plan, because he deserves it. I submit that in a nation that purports to reward skill, ability, and success, some physicians deserve to be high earners just as much as executives of large corporations deserve to be high earners. I submit that these physicians also deserve to be able to retire with pensions as liberal as any executive with similar earnings. There must be enough lawyers on this committee to know that few lawyers will have the high retirement benefits that Senator Dole has been criticizing. I hope we are remembering that all of these executives, doctors, and lawyers will pay income taxes on the pension payments as they receive the payments.

In the past, our income tax laws have always taxed an individual as an individual regardless of his occupation, and they have always taxed each corporation as a corporation regardless of the occupation of its shareholders. As a lawyer with 49 years of practice, I resent legislation that would discriminate against me or any other individual by reason of occupation or would discriminate against any corporation by reason of the occupation of its shareholders. This approach—the listing of certain disfavored occupations—is a recent development in tax thinking. I submit that it is bad policy to enact tax law that will affect an actuary in one way and an insurance broker in another, that will affect a lawyer in one way and a salesman of tax shelters in another, that will affect a physician in one way and an agent for a medical equipment manufacturer in another. The United States Constitution requires equal protection of the laws. I urge Congress to maintain equal protection as sound tax policy.

In 1974, The Pension Reform Act, ERISA, was passed primarily to prevent discrimination against low paid employees. Small businesses have paid the cost of complying with an incredible array of regulations and have struggled to maintain the private pension system. The proposed reduction in the amount of contribution that can be made for owner-employees will cause a proportionate decrease in the contributions for all other employees. The result will be reduced benefits for all employees.

The enactment of this bill would give us a prime example of unintended consequences. I suggest that the drafters of this bill have taken careful aim at a few rich doctors and that the bill hits the nail squarely on the thumb.

STATEMENT OF GRAHAM STAFFORD, ESQ., MCGLINCHEY, STAFFORD, MINTZ & CELLINI, NEW ORLEANS, LA.

Mr. Chairman and Members of the Committee, My name is Graham Stafford. I am a member of the law firm of McGlinchey, Stafford, Mintz and Cellini, of New Orleans, Louisiana. Our firm represents several hundred corporations sponsoring qualified retirement plans covering thousands of employees.

GENERAL COMMENTS

First, Congress would be ill-advised to act on H.R. 6410 until it has had an opportunity to conduct a deliberate, full and fair examination of the proposal. The bill was introduced in mid-May. Less than a month later, this Committee held a one-day hearing on the measure. Markup may be only days away. By contrast, the Employee Retirement Income Security Act of 1974 (ERISA) was the product of an exhaustive ten-year study in which every detail of the proposal was scrutinized. At present, Congress is considering legislative adjustments to the private pension system contained in the Retirement Income Incentives and Administrative Simplification Act (S. 1541 and H.R. 4330). A coordinated examination of these proposals—along with those contained in H.R. 6410—would permit the sort of deliberate and reasoned analysis that such complex and far-reaching measures deserve. Many of those who would be affected by H.R. 6410 are not even aware of its existence. As we will demonstrate, rushing to judgment may produce unintended side-effects such as plan terminations and reduced retirement benefits for rank-and-file employees. The retirement security of millions of American workers is too important to be compromised by a quick-fix tax bill considered under the gun of a record budget deficit.

Second, H.R. 6410 should not be viewed as a revenue measure because there is a substantial possibility the government will actually lose revenue if the bill is enacted. The Treasury has estimated that H.R. 6410 would enhance revenues by $0.1 billion in 1983, $0.6 billion in 1984 and $1.0 billion in 1985. However, the Treasury's projections fail to take into account deductible expenses companies would incur in amending their plans to conform with the new law. H.R. 6410 would require amendments to every qualified corporate plan in America. These costs would be currently deductible and would wipe out most—if not all—of the projected revenue gains, particularly if the initial years after the bill was enacted.

Third, H.R. 6410 reverses long-terms legislative policy encouraging the growth of the private pension system. About 50 percent of recently retired Americans are receiving benefits from their employers. Under current law, it is estimated that by the year 2000, private benefits would be payable to about two-thirds of retired workers. In ERISA and related Acts, Congress enunciated a national policy favoring development of private-sector pension plans. H.R. 6410 would reverse that policy and dramatically reduce the current favorable tax treatment of private plans. At a time when public confidence in the Social Security system is waning, the private pension system should be encouraged—not undermined.

Fourth, reduction in pension contributions may tend to encourage artificial allocations of capital. Private pension plans now hold almost $600 billion in assets and grow at the rate of approximately $20 billion each year. Since these funds are held in a tax-exempt trust, investment decisions turn on such traditional notions such as yield, long-term growth and security of principal. By and large, we see pension money being invested in Treasury securities, bank certificates of deposit, stocks and bonds. The restrictions of H.R. 6410 will inevitably result in a shift of capital from pensions into other investments. Non-pension investments must consider after-tax yields and decisions are often skewed toward tax-favored investments regardless of their traditional investment value or economic productivity. At a time when the country needs substantial investment capital in its basic industries, Congress should analyze carefully how this legislation will affect the flow of investment capital. In particular, it should determine whether H.R. 6410 will result in an artificial reallocation of capital from traditional pension outlets to other tax-sheltered investments that may be less economically productive.

Fifth, Congress should seriously consider whether the miniscule revenue gains promised by H.R. 6410 are worth reducing or blocking establishment of private retirement benefits for millions of American workers. Current legal, actuarial, accounting, and administrative costs incurred to maintain qualified plans are so high that many employers have chosen to abandon existing plans and avoid new ones. The compliance burdens fall particularly hard on small business. One more round of legislative changes requiring plan amendments and resubmission of plans to the IRS will undoubtedly spur a new tital wave of plan terminations. In addition, many companies studying whether to establish qualified plans will choose not to do so. Pension equity will be achieved only to the extent that more workers will be treated equally: They will not enjoy private pension plan benefits.

DISCUSSION OF SPECIFIC OBJECTIONS TO H.R. 6410

A. Reduction of contributions and benefits

H.R. 6410 would reduce contributions to defined contribution plans to $30,000 and would limit benefits under defined benefit plans to $90,000. In addition, contributions and benefits would be frozen at these levels since they would no longer be adjusted for increases in the cost-of-living.

The establishment of limitations pursuant to § 415 of the Code was designed to cap contribution and benefit levels at amounts considered "reasonable." H.R. 6410 would take us back to 1978 limits when levels were presumably "more reasonable." Unfortunately, inflation is the silent thief that steals from us all, and its impact is very uneven among the various sectors of our society. Salaries tend to keep pace, while persons on fixed pensions can only respond by reducing their standards of living.

The plain fact is that a contribution of $45,475 or a benefit of $136,425 today is the same as $25,000 and $75,000 in 1974. Public opinion polls indicate that the failure to index retirement benefits to cost-of-living increases is the primary concern with the private pension plan system. From a national policy perspective, a proposal to permit current funding of anticipated increases in the cost-of-living might come closer to meeting the legitimate concerns of most working Americans. Further, there seems to be fundamental unfairness in reducing contribution and benefit limits (and cost-of-living adjustments) for the private sector without similar and corresponding reductions in Social Security and the retirement benefits of government and military employees.

President Reagan's policies toward reducing inflation appear to be working. If they are permanently successful, future benefit and contribution limits will remain relatively constant. But when most Americans perceive that government is the principal culprit of inflation, Congress should not compound the evil by denying them the means to protect themselves and by punishing corporate employees for the recent inflationary spiral over which they had no control.

Reducing contribution and benefit limits will also cost rank-and-file workers dearly. Plans frequently are fine-tuned to top-out when senior management achieves the highest permissible benefit. A simple example will illustrate the problem.

Assume that Ace Manufacturing is owned by John Smith. The corporation now provides a 25 percent money-purchase pension plan. Smith's salary is $150,000 and the contribution to the plan on his behalf is $37,500. If H.R. 6410 is enacted as proposed, the plan will undoubtedly be reduced to a 20 percent plan since Smith will top-out at $30,000 ($150,000 x 20 percent). Smith's employees will lose 5 percent of payroll. If Smith is more successful next year and can earn $200,000, a 15 percent plan would achieve the proposed § 415 limit. Again, rank-and-file workers at all income levels would suffer.

B. The "1.4 rule"

H.R. 6410 would eliminate the 1.4 Rule now contained in § 415 of the Code.

While the provision is aimed at executives and others considered "highly-paid," it will undoubtedly reduce retirement benefits for the rank-and-file. First, many corporate plans are fine-tuned to provide benefits at the maximum levels for the owners and executives. For instance, a closely-held corporation with a defined benefit plan at the new ceiling will not readily adopt an additional thrift plan or money purchase plan if senior management and the owners cannot participate in the second plan. In addition, companies will reduce or eliminate "second plans" now in effect, a move that will adversely impact younger, lower-paid employees almost exclusively since only the "primary" plan is integrated with Social Security.

Tax incentives involve trade-offs. It is native to think that businesses will provide retirement benefits to rank-and-file workers when the law precludes participation by owners and executives.

C. Actuarial reductions for early retirement

H.R. 6410 would require that defined benefit plans reduce all benefits paid to those who retire before age 65. This is an extremely complex issue. Is the goal full employment advanced by forcing workers to remain on the payroll? Will the rule be applied regardless of years of service or the nature of the work? Thirty years in a coal mine may be viewed as sufficiently long to earn a full benefit. Will it be applied to those in government and the military?

D. Changes in social security integration

H.R. 6410 would reduce the extent to which Social Security benefits could be considered in the design of privately sponsored retirement plans.

Social Security integration is one of the most complex areas of the existing pension law. Possibly methods to simplify these rules exist.

We are not certain that H.R. 6410 achieves simplification or equity. Terribly complex rules would be imposed over the existing maze with all the usual phase-ins, grandfather clauses and exceptions. Furthermore, the bill attempts to equate current contributions with benefits—but no existing correlation exists. We all know that a substantial portion of the recent increases in Social Security benefits now being paid to retired persons is being financed by today's work force.

Let us not lose sight of the purpose of the integration rules.

First, integration reduces "double-dipping"—meaning that an individual should not receive two pensions from the same dollar of wage. Second, integration allows retirement plans to achieve "relative" equality for those workers earning in excess of the wage base.

For instance, if an employee earning $20,000 at retirement receives a Social Security benefit of $1,000 per month, the benefit may be seen as 60 percent of final pay. An employee earning $40,000 receiving the same Social Security benefit is receiving 30 percent of final pay. Again, if the pension plan is not allowed to properly remedy this inequality by fairly considering the first $12,000 in benefits, the private system cannot survive. The costs are simply too great and the necessary incentive is missing.

Again, we would urge further study. The National Commission of Social Security Reform is scheduled to render its report to the President by December 31, 1982. Changing the integration rules at a time when the underlying Social Security benefits may be altered is surely short-sighted—more calculated to produce a flury of actuarial studies and paperwork than any genuine benefit to American workers.

E. Application of Keogh rules to personal service corporations

H.R. 6410 would require application of the Keogh Rules to certain "personal service corporations" operating in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics or consulting.

It is common knowledge that professionals in many fields have incorporated to achieve the same type of retirement benefits enjoyed by corporate executives. Some view this as "abuse." We view the phenomenon as a natural outgrowth of the existing discriminatory legislation.

As a matter of tax policy, the disparity with respect to retirement planning for corporate employees versus the selfemployed should be eliminated. No one should be forced to incorporate to enjoy a comparable pension.

But the bill does not achieve parity. Instead, it singles out certain professionals for punitive treatment and creates a new and potentially disruptive distinction in the law between personal service corporations and those engaged in capital intensive enterprises.

Why should a self-employed physician be forced to retire on less than a physician employed by a major corporation? A successful attorney in private practice would receive less than the general counsel of an industrial concern. Pensions should be geared to earnings, not the place of employment or the form of doing business.

There are those who will argue that a deduction of the lesser of 15 percent of compensation or $30,000 is sufficient. Doesn't that largely depend on when the retirement plan is initiated and how much the professional is earning? Remember that the IRC § 415 limits were designed so that a $25,000 contribution at age 45 would provide a $75,000 benefit at a retirement age of 65.

Why should certain "named" professionals be denied the security of a defined benefit plan when other "unnamed" professionals are not? Why create these artificial distinctions?

We suggest that those behind § 5 of the bill perceive two problems. First doctors and lawyers earn too much money. Second, professionals are more adroit than others at reducing employee costs relative to benefits provided for principals. We submit that the first is irrelevant to the inquiry and the second is largely cured by IRC § 414 (m).

Enacting this punitive legislation does not seriously address itself to either problem. It only discourages the maintenance of plans.

Professional firms employ large numbers of workers who stand to lose millions of dollars in benefits if H.R. 6410 is enacted. By and large, these professionals will have other resources to rely on in the later years. Professionals who are perceived as earning "too much" will be able to provide for themselves in other ways without covering a single employee.

F. Loans to plan participants

As presently written, ERISA permits plan participants to borrow from the plan as long as there is a non-discriminatory loan policy, and the loan is secured, provides for an adequate interest rate and maturity date. H.R. 6410 would retain these provisions for rank and file workers, but would treat loans to certain broadly defined "key" employees as plan distributions.

There can be no question that use of loan provisions is subject to abuse and, if widely used, would undermine the goal of retirement savings. We are not sympathetic with those who use the plan as a tax-favored method of taking vacations and acquiring boats and luxury automobiles.

But doesn't H.R. 6410 go too far? While Congress may believe that abuses will be stopped by preventing plan loans to key employees, the practical effect is that most plans will be amended to delete the loan provisions altogether.

This would be an unfortunate result. First, why not limit plan loans to financial and medical emergencies, education costs, down payments on homes, etc.? Why penalize those willing to work within congressional guidelines because of a few well-publicized "bad boys?"

Second, the committee should understand the "permanence" of pension plans is a deterrent in the minds of many employees who would otherwise elect to establish a plan and to employees who would contribute to their own retirement through mandatory or voluntary contributions. Loan provisions are seen as safety valves.

Completely outlawing plan loans will have a deterrent effect on the contribution levels to existing plans.

G. Estate tax exclusion

Under current law, amounts paid from a qualified plan are free of the federal estate tax if paid to a named beneficiary other than the decedent's estate. This provision was enacted to foster the establishment of plans. Furthermore, we should remember that amounts payable from a pension plan will be subject to the income tax when distributed.

This provision reverses a forty-year trend of favorable pension legislation and will serve as a deterrent to the expansion of private retirement benefits.

MEDIDENTIC, INC.,
June 15, 1982.

JOHN SALMON,
Chief Counsel, House Ways and Means Committee,
Washington, D.C.

DEAR MR. SALMON: On May 19, 1982, Representative Charles Rangel introduced the Pension Equity Tax Act of 1982 (H.R.-6410). In light of the financial troubles of the Social Security Administration and the enormous need for capital to rebuild the United States manufacturing complex to compete in the international marketplace, it is totally counterproductive to reduce the amount of money which can be contributed to the private retirement plan sector which is a major source of investment capital.

Therefore, I adamantly oppose any amendment to the current tax law, including H.R.-6410, which would alter the current tax statutes relating to retirement plans.

Sincerely,

DENNIS C. ANDERSON.

MENASHA CORP.,
Neenah, Wis., June 8, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: As Employee Benefits Administrator of Menasha Corporation, I have just reviewed subject bill proposed by Rep. Charles B. Rangel of New York.

This bill contains provisions which would have a major impact on virtually every defined benefit and defined contribution plan of every employer.

The proposal appears to be a political countermove to current initiatives that would trim Social Security and other entitlement programs. Chairman Rostenkowski reportedly favors incorporating provisions of H.R. 6410 in upcoming revenue-raising legislation. Sen. Slade Gorton commented it is possible that such revenue-raising legislation would become an integral part of a single budget/revenue package which would be submitted to Congress on a yes or no basis.

The types of changes being proposed in H.R. 6410 would be much too pervasive, with severe adverse effects on the nation's overall retirement income system. With Social Security in difficulties, it is imperative to strengthen, not weaken, the retirement security provided through the private sector.

I am concerned that in this pre-election summer, the legislators' haste to impress their constituents by "closing tax loopholes" will not provide the most favorable climate for careful discussion of a complicated issue. Neither will linking this bill to the budget controversy help them make objective decisions.

I respectfully urge you to say NO to H.R. 6410.

Very truly yours,

DEANNA L. JOHNSON,
Employee Benefits Administrator.

RICHARDS, LAYTON & FINGER,
Wilmington, Del., June 11, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, House Committee on Ways and Means,
Washington, D.C.

DEAR CHAIRMAN ROSTENKOWSKI: I have reviewed H.R. 6410 which Representative Rangel recently introduced.

As an attorney who spends a good deal of his time in dealing with employee benefit plan matters, I think that I have the expertise to state that were this bill enacted it would have very wide and undesirable consequences. Contrary to a statement attributed to you, the Rangel Bill would not affect less than 0.5 percent of the nation's workers. Those affected would be far more than a few rich doctors. An excellent analysis of the effects of the Rangel Bill prepared by Towers, Perrin, Forster & Crosby is enclosed for review by you and your staff.

If the Rangel Bill were to become law, the employee benefit plans of just about every employer in the country would have to be re-evaluated, and most of them would be completely rewritten, amended in significant respects or terminated. The cost to businesses would be enormous. The Rangel Bill is not consistent with a national policy to promote capital formation and discourage consumption. It reflects a bias against tax benefits which now encourage the risk-taking associated with the formation of new businesses. In the end, it would result in employers providing less fringe benefits to rank and file employees then they now often enjoy.

In recent years the performance of the Congress in anticipating the impact on the public of employee benefit legislation has been dismal. I do not think Congress foresaw that the Employee Retirement Income Security Act of 1974 would cause every pension plan in the country to be rewritten and permit solvent employers to shift pension plan liabilities to the public through the Pension Benefit Guaranty Corporation. Nor do I think that Congress appreciated that the Multiemployer Pension Plan Amendments Act of 1980 would impose tremendous liabilities on a host of innocent employers who had met all of their commitments under union contracts to fund pensions for their employers. I cannot believe that you realize the potential the Rangel Bill has to disrupt the fringe benefit programs of all employers.

I urge you to oppose the passage of the Rangel Bill, or any similar bill which may be brought before your Committee.

I would be pleased to answer any question which you may have in this connection.

Sincerely,

ROBERT MEYER.

STATEMENT OF STEPHEN I. JURMU ON BEHALF OF THE STATE BAR OF MICHIGAN TAXATION SECTION AND ITS EMPLOYEE BENEFITS COMMITTEE

My name is Stephen I. Jurmu. I offer these comments regarding HR 6410 on behalf of the State Bar of Michigan Taxation Section and its Employee Benefits Committee of which I am Chairman. Polling of the Taxation Section's 1600 members regarding these comments was not possible in the short time available. Comments from those Section members we were able to reach indicated strong support for the comments herein. These comments represent the unanimous opinion of the State Bar of Michigan Taxation Section Employee Benefits Committee. They do not necessarily represent the views of the State Bar of Michigan whose formal policy making bodies, the Representative Assembly and Board of Commissioners, have not (on such short notice) been asked to adopt a position with respect to this issue. The State Bar of Michigan Taxation Section is advised that many able speakers, including Mr. John S. Nolan on behalf of the American Bar Association, will address technical tax issues raised by HR 6410. We wish in this brief statement to limit our comments to several other important matters.

First, we are impressed by the magnitude of the changes proposed by HR 6410. Not since ERISA has Congress so pervasively revised federal pension laws (and, presumably, the pension and tax policies those laws seek to achieve). Notwithstanding the importance of this proposed change in retirement law and policy, hearings limited to one day were scheduled on only twenty days notice. We requested an opportunity to testify and were asked (along with about fifty other interested parties) to submit written testimony instead.

The importance of this legislation notwithstanding, we see little evidence of Congressional fact-finding regarding the fundamental questions of pension policy and budgetary constraints raised by this proposal. Has the Ways and Means Committee estimated, for example, how many private sector retirement plans will teminate in response to HR 6410? Has the Committee determined how many additional private sector employees will be forced to rely solely on the social security system for retirement benefits as a result of this legislation? What is the additional cost to the federal govenment of ensuring adequate social security system funding to provide the benefits those employees will require? And, finally, has the Committee estimated the cost in legal, accounting, actuarial and consulting fees to the private sector to comply with HR 6410 or to terminate existing plans? The Committee's desire to provide very little time for testimony and very short notice of hearings makes it unlikely that its decision on HR 6410 will be based on answers to such basic questions.

Secondly, we see no evidence that HR 6410 is part of any coordinated Congressional policy toward retirement matters. Will this legislation, for example, refine tax incentives in a manner designed to better balance the mix between private sector and public sector (i.e., social security) pension benefits? Does it seek to ensure through tax policy that every American retiree's income will be adequate? Is it even consistent with recent Congressional actions specifically directing tax policy toward increased incentives for a variety of private sector retirement programs (e.g., liberalized rules for IRA programs and salary reduction programs, and portability of retirement benefits). We think that HR 6410 does not contemplate these and other basic questions of federal tax and retirement policy.

Finally, why does HR 6410 reverse a clear Congressional commitment to equality reflected in ERISA? By its enactment of ERISA Congress had, we thought, pointed federal policy clearly in the direction of equal treatment of all similar qualified retirement programs. Congress clearly recognized that unequal treatment of similar plans has no place in federal tax and retirement policy. By creating a new class of qualified retirement plans for purposes of certain key rules, by defining new rules regarding what classes of employees may borrow from plans, and by reaffirming basic distinctions between qualified corporate and Keogh plans, HR 6410 is a major setback for the basic notion of equal treatment in federal pension and tax policy.

HR 6410 is a poor legislative proposals. It rejects a basic congressional commitment reflected in ERISA by establishing different rules for similar qualified plans. It is, to the best of our knowledge, supported by no technical analysis of its true cost to either the private pension system or the social security system. And, finally, it offers neither a clear expression of national pension policy today nor any assurance of what that policy will be in the years ahead for millions of Americans who want only a reasonable opportunity to plan for and save toward retirement.

Statement of Anne M. Disdier, Director of Pensions, Mid-Atlantic Financial Group, Inc., Mt. Laurel, N.J.

(1) DEFINED BENEFIT PLANS: MAXIMUM BENEFIT TO BE REDUCED

(2) DEFINED CONTRIBUTION PLANS: ANNUAL ADDITION CEILING TO BE REDUCED

(3) COMBINATION OF PLANS: THE "1.4 RULE"

Comment

A. Lowering benefit and annual addition ceilings and eliminating the 1.4 rule all result in lower funding. This will greatly diminish pension funds which are a major source of investment capital.

B. Due to the apparent doom of the Social Security system now in effect, to burden the private retirement system with the inability to allow for inflation and to fully fund anticipated payment obligations is irresponsible.

C. Lowering the benefits available to the higher-paid employees will inevitably reflect in diminished benefit levels for the lower-paid employees.

D. The cutback proposed for retirement prior to age 65 will discourage those who can afford to retire early from doing so. This could adversely affect an already severe unemployment problem.

(4) PARTICIPANT LOANS: LOANS TO KEY EMPLOYEES TO BE TAXED AS DISTRIBUTIONS

Comment

A. The most common reasons given for requesting loans from plans are to finance homes, autos and education, all key industries in need of stimulation.

B. The assumption in this case, seems to be that all small business owners and personal service providers are wealthy persons. This is just not the case. In the current economy, most of these key employees cannot afford to put their funds out of reach.

C. Prohibiting borrowing by an employee of his funds under a 401 (K) plan will most assuredly discourage future contributions and could result in employee terminations in an effort to obtain their funds.

(6) PERSONAL SERVICE CORPORATION: TO LOSE STATUS

Comment

A. There should be no artificial distinction between corporate and self-employment and personal service. There appears to be an unfounded prejudice against those employed in personal service industries.

(7) INTEGRATION WITH SOCIAL SECURITY: TO BE CUT BACK

Comment

A. This appears to be a typical example of "reverse discrimination". The employer will have to incur a large funding expense for the lower-paid group before being able to provide for any discrimination—offsetting benefit for the higher-paid group.

B. Those earning in excess of $60,000 will never obtain the full offset benefit due to the "1:2:1 safe harbor".

(9) QUALIFIED PLAN BENEFIT ESTATE TAX EXCLUSION: LIMITED TO $500,000

Comment

A. The reduction of the estate tax exclusion under Code section 2039(c) is inconsistent with the direction of recent legislation. Most pension death benefits are applied to meet the needs of those dependent upon a primary income provider. Death benefits provided under life insurance polices can be free of both income and estate tax with proper planning. Why penalize someone who is self-insuring for this purpose with a tax involving both income and estate taxes?

GENERAL COMMENT

In less than a decade H.R. 6410 is attempting to completely reverse the retirement system that was imposed by ERISA. Employers have expensed billions of dollars to comply with the Pension Reform Act of 1974, and it is both unfair and irresponsible to propose such drastic changes to the system without "grandfather provisions", without substantial notice and without an appropriate compliance period.

This proposed legislation is likely to produce skepticism in the minds of employers, and it will most likely discourage the establishment and maintenance of private pension plans.

STATEMENT OF THE MIDWEST PENSION CONFERENCE

The Midwest Pension Conference respectfully requests that the following comments be considered by the House Ways and Means Committee in connection with its review of the Pension Equity Tax Act of 1982 (H.R. 6410) (the "Bill").

The Midwest Pension Conference (the "Conference") was established 28 years ago and is one of five national pension conferences in the United States. It is composed of employee benefit professionals concerned with employee benefit planning and includes corporate employee benefit specialists, investment counsellors, actuaries and consultants, accountants, attorneys and bank trust officers. Members devote a substantial amount of time to the counselling and development of voluntary retirement programs for employees of corporations and other business entities. Currently, the Midwest Pension Conference has seven chapters located throughout the Midwest with a total membership of almost 1,000 professionals.

The Midwest Pension Conference is extremely concerned about the specific reasons for the introduction of such Bill in Congress and the impact of the Bill on the private retirement system. In brief, the rationale for the Bill appears to be the following:

1. The Bill's sponsor indicates that it is designed to provide greater tax incentives for the inclusion of the broadest possible class of employees in tax subsidized pension plans.
2. Because Congress has under consideration a number of significant reductions in government expenditures for various entitlement and discretionary grant programs, limitaitons should also be placed on the private pension system to provide equitable treatment with such other programs.

The Conference does not believe that this Bill accomplishes either of the objectives specified by Congressman Rangel in introducing the Bill on May 19, 1982. The private pension system has been the backbone for providing retirement income to millions of Americans and their beneficiaries for years and this Bill will do nothing to provide additional incentives by employers to establish plans and, in fact, will discriminate against smaller employers which provide professional services. Our concerns include the following:

1. At a time when most employers have finally conformed plan provisions to the complicated provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), including limitations on contributions and benefits specified in ERISA, it is not likely that employers, particularly smaller employers, will be willing to incur added expense in conforming plan provisions to this Bill, especially if the effect of the Bill is to cut back contributions or benefits provided under such plans for employees of a company simply because of their positions within such company. Certainly, professional corporations and other smaller employers will have no incentive to establish new plans for their employees with the restrictions contained in this Bill.

2. Modifying the Social Security integration rules will require substantial modifications in most defined benefit pension plans and substantial cost in conforming such plans with the new requirements. The cost in making such changes and the additional costs incurred by employers to fund such increased benefits will in the case of many employers, large and small, result in the curtailment or termination of such plans, benefiting neither the employees of such entity nor the country as a whole.

3. Contrary to the statement made that the Bill will provide greater tax incentives for establishing pension and fringe benefit plans for employees, the Bill will not cause new plans to be established and will actually cause the curtailment and termination of such plans with two likely consequences:

(a) The American workforce employed by smaller employers, including professional corporations, will not have private retirement plans to supplement Social Security benefits at retirement. This will cause the imposition of an additional burden on the Social Security system at a time when that system is already overburdened with benefits exceeding the revenues necessary to support the system.

(b) With the curtailment and termination of plans, the retirement "savings" of participants through employer and employee contributions to such plans will be reduced. In addition, the amount of available capital provided by such savings for expansion by American business and to satisfy federal borrowing needs will be reduced.

Although the Bill would have some revenue impact, nothing in the Bill indicates that revenue was a primary consideration in its introduction.

4. If the purpose of the Bill is to provide a basic "parity" or "fairness" between the private pension system and other federal entitlement and grant programs, which, as discussed below, the Conference does not believe to be the case, this Bill should not be considered unless the indexing and benefits under all government pension programs, including military pensions, civil service pensions, compensation of government employees, social security and other entitlement programs, congressional pensions and other grants, are frozen. In addition, a thorough review should be made of all government pensions to determine whether the limits provided in such plans are reasonable in light of the proposed intentions of this Bill.

5. The assumption is made that the private pension system is nothing more than an entitlement program involving an indirect tax expenditure by the federal government. The Conference believes that there is a substantial difference between a system that provides an inducement for emplyers and employees to "save" for employees' retirement and programs benefiting individuals who are dependent on such programs out of taxes paid by working Americans. Employers and wage earners should not be categorized with individuals receiving entitlement, and other discretionary grant, programs and should not be discriminated against because they work for a living and provide for their retirement. By paying federal taxes on their employment earnings and at the same time participating in the retirement plans of their employers, they are serving two national purposes—providing the revenue necessary to provide government services (including entitlement and other grant programs) and accumulating retirement savings, thereby reducing the burden of the Social Security system and the country in providing benefits to such individuals during their retirement years.

Based on the foregoing, the Midwest Pension Conference believes that H.R. 6410 does not satisfy either of the objectives stated when the Bill was introduced and will dampen the growth of private retirement plans.

MORRICE, LENGEMANN & RICHARD,
Imlay City, Mich., June 17, 1982.

WAYS AND MEANS COMMITTEE,
Capitol Building,
Washington, D.C.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE: My name is Robert C. Tourek and I am presenting this statement on behalf of the law firm of Morrice, Lengemann & Rickard, Professional Corporation, of which I am a member. My firm is located in Imlay City, Michigan.

I am writing, with the hope that it may influence the committee members to permanently shelve H.R. 6410. While the purpose of the legislation may be to provide a greater tax incentive for pension plans to include the broadest possible class of employees, I feel the opposite would be the outcome. The proposed legislation will cause the reduction of retirement benefits across the board, and more, probably cause the termination of numerous qualified retirement plans, rather than broadening their benefits.

Specifically, I see that passage of the bill will result in the following:

(1) Provisions of the legislation which call for the reduction of maximum plan contribution or benefit limits will result in the highly compensated officials to seek out additional tax shelters for money not contributed to the pension plan.

(2) Some employers, who have been inundated with prior government restraints and regulations, will see the costs of complying with this legislation as burdensome and terminate their plans.

(3) Discrimination of the tax laws against professionals for which there seems to be no justification.

I would hope that the above reasons might persuade members of the committee to consider the disastrous outcome it could have on the professional pension system.

Respectfully yours,

Robert C. Tourek.

Multimedia, Inc.,
Greenville, S.C., June 15, 1982.

Hon. John J. Salmon,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: I am writing to ask that you actively work to prevent the passage of H.R. 6410, the inappropriately named "Pension Equity Tax Act of 1982". This proposed legislation would make near-sighted changes to the law affecting employee benefit plans in the areas of benefit and contribution limits, social security integrations, participant loans and other employee fringe benefits.

The legislation if passed in its present form will cause terminations of existing plans, limit employer-sponsored employee savings, increase the administrative cost of existing plans and reduce employer interest in establishing new or improving existing benefit plans. At a time when the Social Security system is flirting with insolvency and the American worker is facing an insecure retirement, these changes seem inappropriate.

The current tax benefits which flow from deferred benefit plans produce important benefits for a broad cross-section of the American population. Near-sighted, rapidly constructed, tax increasing provisions such as H.R. 6410 should not be permitted to damage the private pension system.

Sincerely,

Donald J. Barhyte,
Vice Chairman, Treasurer.

[Note.—A letter identical to the above was also received from Jane M. Clamp, manager, Corporate Administrative Services.]

Statement of Converse Murdoch, Esq., Murdoch & Walsh, Wilmington, Del.

SUMMARY OF STATEMENT

1. The witness' law firm and over 350 small business clients would be adversely affected by the enactment of H.R. 6410.

2. A strong private pension system is a unique source of capital and may well furnish the only source of money for individuals whose working careers are terminated or interrupted.

3. Because most small businesses are dependent on the personal involvement of a few owners who are also active employees, small businesses have a need to fund out of current earnings to provide for future benefits.

4. The likely result of enactment of H.R. 6410 will be the termination or drastic curtailment of retirement and fringe benefit programs for rank and file employees—particularly those in the small business sector.

5. Such curtailments will not produce greater tax revenues.

6. H.R. 6410 will result in blatant and unjustifiable discrimination against persons working for personal service businesses.

WITNESS' INTEREST IN BILL

I have been an attorney for over 34 years. Except for a period of 4½ years during which I was employed by the Bureau of Internal Revenue, my legal experience has been as a private practitioner.

I am presently the senior attorney in the law firm of Murdoch & Walsh, P.A. in Wilmington, Delaware. Most of our clients are small businesses and their principals.

I am the Vice President for legislation of the Small Business Council of America, Inc. My statement is not submitted on behalf of that organization, but rather on behalf of my law firm and over 350 small business clients who would be directly and adversely affected if anything even closely resembling H.R. 6410 became law.

THE RELATIONSHIP BETWEEN RETIREMENT AND FRINGE BENEFIT PROGRAMS, SMALL BUSINESS AND THE NATION AS A WHOLE

Other statements being presented by other individuals and groups demonstrate beyond any doubt that small business is important to the nation and that adequate retirement and fringe benefit programs for small businesses and their employees should be encouraged rather than discouraged. Other witnesses will demonstrate that the private pension system in the United States is essential for at least two reasons. The private pension system is the greatest source of capital in our country today. It is unique as a source of capital because it represents savings out of current earnings as opposed to a mere shifting of capital from one form to another.

Because of the capital producing potential of the private pension system, Congress should not precipitously take any step which responsible persons believe could either curtail or possibly destroy the private pension system.

The private pension system is important to the nation as a source of much needed capital. It is every day becoming more important for the very survival of disabled and retired persons because of the generally conceded near bankrupty of the Social Security System. Persons of different political and social philosophies can disagree on how the social security crisis should be met—there can be no bona fide disagreement with respect to the proposition that we are rushing headlong towards a social security crisis.

THE SPECIAL PROBLEMS OF SMALL BUSINESS

Persons employed in the small business sector face problems which are sometimes overlooked and sometimes simply ignored by those employed by big government, big business, big unions and big tax exempt organizations (these I will refer to hereafter as "institutional employers"). I am not aware of any individual in the small business sector who is proposing that there be any sort of punitive steps taken with respect to retirement plans maintained by institutional employers. All that we in the small business sector ask is that our representatives in government recognize our problems and not interfere with our attempts to solve our own problems. We are not asking for subsidies, bailouts, or other government relief. We have only one modest request, and that is that government not frustrate our attempts to solve our own problems at our own expense.

For practically all small businesses, providing for adequate security against disability, termination of employment and retirement means saving from current earnings to provide funds which can be drawn down later at a time when earnings cease for one reason or another. The smaller the business, the more true that is.

Assume the situation of an individual who owns his own business and is the only person working on it. The day that individual ceases working, either voluntarily or involuntarily, is the day that his income stops. Unless he is fortunate enough to have inherited wealth, his only source of support after termination of employment is from savings accomplished out of earnings while he was active. It's that simple. No responsible individual in the light of present circumstances, can assume that those statements are inaccurate because of the possibility of social security payments.

Contrast that sole proprietor's situation with that of an individual employed by an institutional employer such as a big business, a big government, a big union or a big exempt organization. Those institutions have lives of their own independent of any one individual. Those institutions can make (and probably deliver on) meaningful promises to one or more individuals to take care of them once their employment terminates. That is simply not so in most small businesses.

The hypothetical case of a business entirely dependent upon one person dramatically points up the problem of all small businesses. The same problems exist in the case of small businesses involving more than one individual.

Assume a small business with five working individuals. In pure theory, the five individuals can promise themselves in the event of termination of active service due to disability, retirement, or whatever. Delivery on promises of that sort often can not be made. If there is delivery on that promise, it involves a painful sacrifice on the part of the few so-called "fortunate" ones who are able to continue working. It's simply not in the cards to expect a few active people to go on indefinitely sharing their earnings with persons who have become disabled or retired.

Again, all that this demonstrates is what should be obvious to any thinking person, i.e., small business has peculiar needs when it comes to funding now for later benefits.

THE LIKELY RESULTS IN THE SMALL BUSINESS SECTOR IF H.R. 6410 IS ENACTED

By and large, small business employees are not represented by strong unions which have the power to compel their employers to establish retirement and other fringe benefits. Many of the rank and file employees in the small business sector are young persons. As such, these young employees are happy to accept coverage under retirement and other fringe benefit programs, but given their druthers, many of these young employees would prefer a cash wage increase to better fringe benefit and retirement programs.

Whether out of the goodness of their hearts or because of incentives in the tax laws, small business employers generally extend coverage of retirement and fringe benefit programs to their rank and file employees. However, since the enactment of ERISA in 1974, more and more small business employers are crying "enough is enough", as they are repeatedly told that their fringe benefit programs must be revised to comply with what appears to be a never ending stream of statutory amendments and new regulations and rulings.

One has only to look at the history of retirement plan terminations and the drop-off in installation of new plans which followed the enactment of ERISA to realize that small business employers are not willing to go on indefinitely incurring the costs and hassle which go with complying with new laws. It is no idle threat to say that if anything even closely resembling H.R. 6410 is enacted, you in Congress will, within a matter of a few months, find that more and more of your constituents are dropping out of qualified retirement and fringe benefit programs.

Many who urge legislation such as H.R. 6410 honestly believe that by enacting such legislation, they will insure the spread of benefits to more rank and file exployees. That is simply not the way it works in real life. Faced with the prospect of completely revising retirement and fringe benefit programs to comply with H.R. 6410, many small business employers are going to tell their rank and file employees that they're giving them a cash raise (which the employees will welcome) and they're dropping their various fringe benefit programs. Unfortunately, this shift will not be felt in an adverse way by most employees until some future date when they fall ill or are terminated from their employment for retirement or other reasons.

Theoreticians may sincerely believe that cutting down the amount which an employer can deduct for retirement and fringe benefit program purposes will produce revenue equal to an assumed tax rate multiplied by the disallowed deductions. This is not what will happen. Instead of paying taxes on what would otherwise have gone into a retirement program, many small business employers will get swept into the search for "tax shelters". This is not good for the Treasury or the nation as a whole. With justification, responsible persons in and out of government are concerned about the short and long-range effects of a tax system which encourages the spread of tax shelters which produce little, if any, new worthwhile economic activity. Many tax shelters produce nothing but numbers on tax returns. Yet, if what are generally conceded to be worthwhile capital producing retirement plans are discouraged, more of what would otherwise be our needed capital, will be diverted into tax shelter programs.

H.R. 6410 WOULD RESULT IN BLATANT DISCRIMINATION AGAINST SMALL BUSINESS AND PARTICULARLY THOSE IN THE SERVICE AREAS

For reasons not disclosed, the proponents of H.R. 6410 proceed on the assumption that key employees in small businesses are not entitled to the same tax treatment as their associates and neighbors working for institutional employers such as big government, big unions and big exempt organizations. The proponents seem to single out for particularly discriminatory treatment those who are in the service sector of the small business community.

Why should an attorney in private practice who has a greater than 5% interest in a small law firm be treated differently than his neighbor who is an attorney employed by a large manufacturing corporation and whose interest in the stock of the large manufacturing corporation may be worth millions of dollars even though it represents a miniscule percentage of the outstanding stock of the publicly held corporation? Why should there be a punitive rule applicable to a pension plan for the benefit of an engineer who works for a small engineering firm while his neighbor who is an engineer employed by the United States government, is given far different treatment for retirement planning purposes? These distinctions make no sense in terms of logic, fairness or good public policy.

If there are perceived abuses in the private retirement and fringe benefit areas, they should be specifically addressed after being clearly identified. They should not be assumed to exist, particularly when the assumed remedy could well result in many perfectly bona fide retirement and fringe benefit programs being abandoned and their beneficiaries made dependent on the government for support after termination of gainful employment.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS,
New York, N.Y., June 16, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The National Association of Mutual Savings Banks (NAMSB) appreciates the opportunity of commenting on certain proposals contained in the Pension Equity Tax Act of 1982 (H.R. 6410) presently under consideration by the Ways and Means Committee.

NAMSB is a trade association representing the 435 savings banks in the United States. To the extent that the proposal would increase and expand the ability of self-employed individuals to contribute to so-called H.R. 10 or Keogh plans and to the extent that such increased coverage would place these limits more closely in line with retirement benefits which may be provided for corporate employees, NAMSB wholeheartedly endorses the proposals. However, to the extent that the proposal would decrease contribution limits and retirement benefits available to corporate employees generally, NAMSB would caution the Committee not to impede what has become one of the primary sources of saving in the United States.

With respect to the specific provisions of the proposal, the savings bank industry has long been in favor of those proposals which would expand the ability of individuals and businesses to provide for the retirement of their employees through tax-deferred compensation arrangements. Accordingly, we have supported expansion of the deductible contributions limits for Keogh plans over the years, including the most recent increase under the Economic Recovery Tax Act of 1981 (ERTA), which increased the maximum amount of funds a self-employed individual can put aside annually for himself or his employees from $7,500 to $15,000. We supported this amendment to the Internal Revenue Code as a just recognition of the fact that the form of business enterprise—whether a corporation, partnership, or sole proprietorship—should not affect the amount of funds which may be set aside under a qualified tax-deferred arrangement. Accordingly, our industry supported those provisions of the Employee Retirement Income Security Act of 1974 (ERISA) permitting the establishment of individual retirement accounts (IRAs)—retirement accounts which are now available to all individuals whether or not they are covered by qualified pension or profit-sharing plans or by Keogh plans.

The long-term nature of retirement accounts makes them ideally suited for thrift institutions which have long promoted systematic savings in this country. It has been our position that the encouragement and incentive to save will dampen inflationary pressures and stimulate the capital investment necessary to provide for economic recovery and a reduction of the tremendous budget deficits which the Administration now faces.

With respect to the proposed reduction in the annual contribution limits on behalf of each plan participant to a defined contribution plan from $45,475 to $30,000 and the reduction in annual benefits from $136,425 to $90,000 in the case of defined benefit plans, we would question the propriety of undertaking any reduction in retirement savings at the present time. While we fully recognize the equity in attempting to establish equivalent benefits for employees regardless of the form of business enterprise, we would suggest that it would be more appropriate to increase further the ability of self-employed individuals and individual proprietors under Keogh plans and IRAs to provide for retirement benefits more closely matching the benefits available to corporate employees, rather than to undertake any reduction in retirement savings for corporations.

While the proposal would apply these provisions beginning in years ending after 1983 for existing corporate retirement plans, we would question the application of these proposals to existing employees under existing plans. Under present law, with respect to defined benefit pension plans, the annual benefit is the equivalent of a retirement benefit for the life of the employee, beginning at age 55 or later, without regard to certain survivor benefits. If the retirement benefit begins before age 55, the annual benefit limitation is reduced to the actuarial equivalent of the full limit.

Under the proposal, if the retirement benefit under a defined benefit plan begins before age 65, the annual benefit limitation which would be reduced from $136,425 to $90,000, would be further reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 65. It is submitted that if such an amendment is made with respect to employees retiring early, that such a reduction be made applicable only to new employees after the date of enactment or to employees of a qualified pension or profit-sharing plan estblished after the date of enactment. Application of such a reduction to existing employees of plans already in existence would seriously undermine the rightful expectations of many corporate employees.

Under present rules, a qualified retirement plan generally is permitted to make a loan to a plan participant as long as the loan bears a reasonable rate of interest, is adequately secured, provides for a reasonable repayment schedule, and is available on a non-discriminatory basis. At the same time, loans to an owner-employee of a Keogh plan are not permitted. The proposal would treat loans under a corporate plan to so-called "key employees" as a taxable distribution.

It is respectfully submitted that under many existing qualified retirement plans, particularly those which are contributory in nature, employees have made contributions with the expectation of the privilege of being able to borrow from the plan. We see no advantage in disrupting such an expectation but rather if it is considered essential to establish equity vis-a-vis so-called Keogh plans, that the privilege of borrowing be extended to Keogh plans, provided existing safeguards are established, including a reasonable rate of interest, adequate security, as well as provisions against discrimination.

In conclusion, NAMSB supports the proposals to the extent that they seek to achieve a more equitable treatment of all individuals with respect to deferred retirement programs, regardless of the form of business enterprise involved. At the same time, we would seek to achieve this equity through increasing the opportunities to establish long-term systematic savings programs for retirement rather than reducing existing corporate retirement savings programs.

Sincerely,

FREDERIC S. KRAMER, *Tax Counsel.*

STATEMENT OF THE NATIONAL ASSOCIATION OF PENSION FUNDS

The National Association of Pension Funds (NAPF) is a nonprofit membership organization which has been recently established to meet the need for a single association that can represent pension funds on issues of concern to them before the Congress and Federal, State, and local governmental agencies. NAPF will have as Members the corporate, union, and public employee pension funds that desire to coordinate action to strengthen their views on matters of current concern to them. There are three sections of the Association to accommodate these different groups, and their decisions will be governed by a common Board of Directors. In addition, other organizations, such as mortgage banking firms, investment bankers, actuaries, and pension consultants, which have a demonstrated interest in pension fund management are being invited to join NAPF as Associate Members. NAPF is currently recruiting Members and Associate Members.

The National Association of Pension Funds opposes H.R. 6410 because we believe it would reduce the incentives for making voluntary contributions to private pension plans and thereby weaken the private pension system. The stated objective of the bill is to provide greater incentives for comprehensive inclusion of the broadest possible class of employees in qualified pension plans, but the impact this legislation would actually have on employees currently covered by private pension plans does not appear to have been fully analyzed or understood.

The bill would severely disrupt the private pension system. Such a significant pension reform measure that would affect so many people and so many pension plans should not be hurried through the legislative process without careful consideration of its ramifications. In summary, the National Association of Pension Funds opposes H.R. 6410 because of the potential impact of the bill on rank-and-file employees, the costs of making major changes in plans to comply with new rules, and the relatively small amount of revenues that would be raised.

The bill is the first step in the wrong direction. H.R. 6410 would be contrary to the National policy objective of increasing savings and promoting the growth of long-term investment capital generated by the private pension system. Reduced limits on the deductability of contributions made to qualified plans will have an adverse impact on savings and investment. In addition, sweeping changes in the laws governing qualified plans will require substantial administrative costs to be incurred in amending plan provisions to comply with changes in Federal law. The administrative burden can be expected to lower incentives to continue and improve existing plans and establish new plans. As a result, fewer rather than more employees would be covered by the private retirement system.

The dollar limits for contributions made to qualified plans should not be reduced to $30,000 for defined contribution plans and $90,000 for defined benefit plans. These reductions are targeted at the most highly compensated individuals in companies, but are likely to result also in reduced contributions being made for rank-and-file employees. Plans generally maintain a relationship between the benefits paid to employees according to compensation levels, and, if the level of benefits is required to be reduced for the key senior employees of a company, it is likely that they will decide to amend the plan to cut back the benefits available to the rest of the employees. Thus a practical application of nondiscrimination formulas may well mean that contributions and benefits for lower-paid employees will be proportionately reduced.

Contributions no longer made to qualified plans because of reduced limits would not likely be allocated to more coverage of middle and lower income workers because those amounts could be shifted to excess benefits plans for the continued benefit of the key senior employees. Moreover, incentives for improving benefits on a company-wide basis and establishing new plans would be lessened where top management would not themselves receive the benefit of increased retirement income from qualified plans. For these reasons it does not appear that the objective of expanding coverage of the private pension system for more rank-and-file workers could be met by reducing limits on the contributions that are now made.

The cost of living adjustments to the dollar limits for contributions made to qualified plans should not be eliminated because the effects of inflation on retirement benefits over time should be taken into account. The existing adjustment provision may need revision so that the index applied is a more appropriate standard, but there should not be a total repeal of COLAs for the private sector. It would not be tax equity to impose these limits on the private pension system while indexing of Federal employees' pensions continues and cost of living adjustments remain intact in the Social Security system.

The 1.4 limit for combinations of defined contribution and defined benefit plans should not be reduced to 1.0 because that change will also serve to reduce contributions to pension plans made for the benefit of lower-paid, rank-and-file employees. The 1.0 ratio would require an employer who maintains more than one plan for his employees to amend the benefit and contribution formula and reduce benefits for most employees. The potential is here for termination of defined contribution plans which have been created secondarily to supplement defined benefit plans, but may no longer be considered advantageous if no further benefits can accrue to the senior, more highly compensated employees.

Any revision of the rules governing integration of plan contributions with benefits under the Social Security system should be more carefully considered to seek administrative simplicity and equity of treatment among plan participants. Changes in the integration rules should be proposed only after receipt and review of the recommendations of the National Commission on Social Security Reform. These rules are highly technical, and the impact of any changes needs to be fully understood, particularly with respect to effects on the retirement income of rank-and-file workers, before proceeding with new legislation.

The changes in the rules governing owner-employee plans and plans benefitting self-employed individuals should be revised to achieve their stated goal of parity for self-employed individuals by giving like tax treatment to corporate and noncorporate plans. There should not be discrimination in the tax provisions based on the form of organization of a business. In meeting that objective, this bill should not be creating new distinctions based on an individual's occupation or the types or size of the business.

H.R. 6410 has been met with strong opposition from the pension fund community because it has been viewed as an attempted exercise of increased Federal control over the savings and investment decisions that are currently made within the framework of existing laws and regulations. The private pension system is voluntary, and any governmental attempt to reduce the amount of pension funds available for capital investment or to allocate those funds or any portion of them for public programs or particular social objectives is unwise.

In conclusion, we believe that at this time Congress should not be seeking to raise revenue from changes in tax provisions governing the private pension system, but should focus on strengthening the private pension to protect the retirement income of plan participants covered under private sector pension plans.

Statement of Dow Reichley, President, and Nick A. Verreos, Chairman, Federal Affairs Committee, National Association of Professional Insurance Agents

The following position statement is submitted to the Committee on Ways and Means by the National Association of Professional Insurance Agents (PIA).

PIA is a national trade association representing more than 38,000 independent property and casualty insurance agents in all 50 States, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

H.R. 6410, The Pension Equity Tax Act of 1982, contains a number of provisions that would impose restricted limits on private pension, thrift, profit-sharing and other employee benefit plans. In brief, the bill would reduce current allowable limits in the following manner:

1. Defined contribution plans would be reduced from $45,475 to $30;000. Defined benefit plans would be reduced from $136,425 to $90,000.
2. Annual cost of living adjustments would be eliminated.
3. The 1.4 rule is reduced to a new 1.0 rule for combined defined contribution and benefit plans.
4. Normal retirement age is set at 65 with benefits reduced if the person elects to retire at an earlier age.
5. Loans to key employees, officers, etc., would, as a practical matter, be prohibited.
6. Integration with the social security program is restricted.
7. Keogh plan rules are applied to professional service corporations.
8. Estate tax exclusion limits are set at $500,000.

As introduced, H.R. 6410 contains many provisions which will adversely affect the economy in general and numerous small businesses, including independent insurance agencies. Reduction and/or elimination of the current tax incentives for private sector pension plans will have both immediate and long term adverse effects. These provisions will immediately serve to substantially reduce a large pool of capital which today provides a major source of funds which can be borrowed. This source of capital contributes to economic growth and an expansion of business activity, creating a need for goods and services and new jobs. Elimination of these tax incentives will have the additional long term effect of reducing available private sector retirement funds which will in turn place an increased public demand upon the already overburdened social security system.

The current incentive provisions of ERISA and related tax provisions were developed after an extended period of legislative scrutiny and took into consideration future public and private sector needs, particularly in light of actuarially based age/demographic statistics which project a massive retirement age group beginning in approximately twenty to thirty years. Viewed in this light, PIA would think that reasonable legislators would continue to support legislation encouraging private sector retirement programs rather than making future retirees more dependent upon governmental largess.

Particularly distressing to independent insurance agents is the blatant discriminatory thrust of this legislation which will affect small businesses to a greater degree than large corporations. The small businessperson takes substantial risks in establishing their business and day to day they bear a greater burden of economic survival than well-established large corporate entities. Yet as small businesses fail in increasing numbers, reflecting the greater risk of doing business these days, small firms would be confronted with one more disadvantage if H.R. 6410 were to become law. This legislation implies that the large stockholders of small businesses deserve less in retirement compensation and benefits than employees of large corporations who take nowhere near the same risk. Although the bill applies to all firms, the large corporation is in a far better position to develop alternative methods of compensating management and, as a practical matter, alleviating the impact of this bill on key employees.

The single redeeming quality that this legislation offers, which appears to be completely out of character with the rest of its provisions, is a token increase in H.R. 10 (Keogh plan) tax exempt contributions. The level of even these increased contributions is of questionable sufficiency, however.

Responsible laws and legislation in this area must have certain minimal requirements including:

1. Inflationary adjustments for both maximum benefits payable and maximum contributions.
2. Non-discriminatory treatment of small businesses.
3. Non-discriminatory treatment of classifications of businesses and
4. Incentives for the continuation and EXPANSION of private sector pension plans to reduce the draw on the already near bankrupt social security system.

PIA therefore opposes H.R. 6410, as introduced, and urges the Ways and Means Committee not to include its provisions in any tax legislation reported for enactment by the 97th Congress.

Thank you Mr. Chairman, for providing us with this opportunity to present our views.

National Association of Wholesaler-Distributors,
Washington, D.C., June 17, 1982.

Hon. Dan Rostenkowski,
Chairman, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

Hon. Barber Conable,
Ranking Minority Member, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

Dear Messrs. Rostenkowski and Conable: The National Association of Wholesaler-Distributors, its 121 national association affiliates (see attached) and 45,000 members strongly oppose the Pension Equity Tax Act, H.R. 6410. We exhort this Committee, in the most strenuous terms, to delay its present consideration of this legislation, or any of its provisions, as it seeks to identify measures for reducing the deficit.

The Committee's current agenda and timetable are inappropriate for evaluating legislation of such far reaching implication to so many people. Hasty action in this area by Congress could have the most serious, unintended consequences for our private retirement system. As such, any further action on H.R. 6410 should be postponed until this Committee can devote the time and resources necessary to an in-depth inquiry into all of its ramifications, both direct and indirect.

With over 5.4 million employees at 307,000+ locations throughout the 50 states, the wholesale distribution industry is substantially involved in the sponsorship and administration of pension plans. The tax incentives for plan sponsorship have been significant inducements for wholesaler-distributors, as they have been for other employers; and they remain so despite the onerous and complex paperwork and administrative burdens associated with plan sponsorship.

However, we believe that considerable damage could be wrought to these incentives through changes set forth in H.R. 6410. Alterations in the current limitations related to defined contribution plan additions and benefit maximums under defined benefit plans (Section 415 of the Internal Revenue Code) would be particularly harmful. Elimination of the cost-of-living adjustment factor would further dilute incentives for plan sponsorship, as would actuarial reductions for defined benefit plan recipients retiring before age 65. Furthermore, the Keogh plan loan restrictions, while offered in the name of equity, are discriminatory to business owners and key employees and would be viewed as such.

In addition to reducing incentives for private plan sponsorship, H.R. 6410 would also require significant plan restructuring and increase the complexity of administration—an already difficult burden for smaller companies. In this regard, Social Security integration would pose a particular problem. Any actions affecting Social Security should be postponed until the National Commission on Social Security Reform has completed its study in December.

In conclusion, while we share this Committee's concern about the deficit, we urge Members to refrain from further action on H.R. 6410 at this time. To the extent that there may be abuses or certain inequities in the private retirement system, further detailed inquiry may be warranted.

Thus far, private pension plans have served us well. They will continue to meet America's growing need for retirement income provided the appropriate incentives and inducements are retained.

Given the uncertain future of the Social Security System, any disruption in the growth and development of private pension programs would have serious consequences.

NAW believes that H.R. 6410 would disrupt plan sponsorships in wholesale distribution and frustrate the formation of new plans.

I hope these comments will prove useful in your deliberations on this matter.

Sincerely,

DIRK VAN DONGEN, *President.*

NATIONAL WHOLESALER-DISTRIBUTOR ORGANIZATIONS AFFILIATED WITH THE NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS

Air-conditioning & Refrigeration Wholesalers; American Dental Trade Association; American Jewelry Distributors Association; American Machine Tool Distributors' Association; American Supply Association; American Surgical Trade Association; American Traffic Services Association; American Veterinary Distributors Association; Appliance Parts Distributors Association, Inc.; Associated Equipment Distributors; Association of Footwear Distributors; Association of Steel Distributors; Automotive Service Industry Association; Aviation Distributors & Manufacturers Association.

Bearing Specialists Association; Beauty & Barber Supply Institute, Inc.; Bicycle Wholesale Distributors Association, Inc.; Biscuit & Cracker Distributors Association.

Ceramic Tile Distributor Association; Ceramics Distributors of America; Coated Abrasives Fabricators Association; Cooperative Food Distributors of America; Copper & Brass Servicenter Association; Council for Periodical Distributors Association; Council of Wholesale-Distributors, American Institute of Kitchen Dealers.

Distributors Council, Inc.; Door & Hardware Institute; Drug Wholesalers Association.

Electrical-Electronics Materials Distributors Assn.; Explosive Distributors Association, Inc.; Farm Equipment Wholesalers Association; Flat Glass Marketing Association; Fluid Power Distributors Association, Inc.; Food Industries Suppliers Association; Foodservice Equipment Distributors Association.

General Merchandise Distributors Council; Hobby Industry Association of America; Independent Medical Distributors Association; The Irrigation Association; Institutional & Service Textile Distributors Association, Inc.; International Ceramic Association.

Machinery Dealers National Association; Mass Merchandising Distributors Association; Material Handling Equipment Distribution Association; Monument Builders of North America-Wholesale Div.; Motorcycle Industry Council; Music Distributors Association.

National-American Wholesale Grocers' Association; National Appliance Parts Suppliers Association; National Association of Aluminum Distributors; National Association of Chemical Distributors; National Association of Container Distributors; National Association of Decorative Fabric Distributors; National Association of Electrical Distributors; National Association of Fire Equipment Distributors; National Association of Floor Covering Distributors; National Association of Manufacturing

Opticians; National Association of Marine Services, Inc.; National Association of Meat Purveyors.

National Association of Plastics Distributors; National Association of Recording Merchandisers, Inc.; National Association of Service Merchandising; National Association of Sporting Goods Wholesalers; National Association of Textile & Apparel Distributors; National Association of Tobacco Distributors; National Association of Writing Instrument Distributors; National Beer Wholesalers Association; National Building Material Distributors Association; National Business Forms Association; National Candy Wholesalers Association; National Commercial Refrigeration Sales Association; National Electronic Distributors Association; National Fastener Distributors Association; National Food Distributors Association; National Frozen Food Association; National Independent Bank Equipment Suppliers Assn.; National Industrial Belting Association; National Industrial Glove Distributors Association; National Lawn and Garden Distributors Association; National Locksmiths' Suppliers Association; National Marine Distributors Association.

National Paint Distributors, Inc.; National Paper Trade Association, Inc.; National Plastercraft Association; National Sash & Door Jobbers Association; National School Supply & Equipment Association; National Solid Wastes Management Association; National & Southern Industrial Distributors Associations; National Spa and Pool Institute; National Truck Equipment Association; National Welding Supply Association; National Wheel & Rim Association; National Wholesale Druggists' Association; National Wholesale Furniture Association; National Wholesale Hardward Association; Northamerican Heating & Airconditioning Wholesalers; North American Wholesale Lumber Association, Inc.

Optical Laboratories Association; Outdoor Power Equipment Distributors Association; Pet Industry Distributors Association; Petroleum Equipment Institute; Power Transmission Distributors Association, Inc.

Safety Equipment Distributors Association, Inc.; Scaffold Industry Association; Shoe Service Institute of America; Specialty Tools & Fasteners Distributors Association; Spring Service Association; Steel Service Center Institute.

Textile Care Allied Trades Association; Toy Wholesalers' Association of America; United Pesticide Formulators & Distributors Association.

Wallcovering Distributors Association; Warehouse Distributors Association for Leisure & Mobile Products; Watch Materials & Jewelry Distributors Association; Water and Sewer Distributors Association; Wholesale Florists & Florist Suppliers of America; Wholesale Stationers' Association, Inc.; Wine & Spirits Wholesalers of America, Inc.; Wood Heating Alliance; Woodworking Machinery Distributors Association.

STATEMENT OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION

The National Automobile Dealers Association (NADA) is a trade association representing over 18,000 retail automobile dealers nationwide. The association maintains a trust fund as a service to its members, administered by the National Automobile Dealers and Associates Retirement Trust (NADART), which includes over 5,000 retirement plans for individual automobile dealerships. These plans cover 80,000 participants. This trust has assets of over $450 million dollars.

We are extremely concerned about the impact that H.R. 6410 will have, not only on those plans but on the many plans maintained separately by our members, many of which maintain multiple plans individually and administered by NADA. We believe that this legislation will have a serious negative effect upon both the formation of new plans in the small business sector, and also the continuing maintenance of such plans.

H.R. 6410 purports to establish "equity" in private pensions. We believe the impact is not understood fully. By forcing reductions in the amount of benefits available to participants under pension plans by reducing the integration rules and cutting the Code Section 415 limits, increased pressure will be put on the Social Security system. This is not wise considering the plight of the Social Security system. A presidential commission is now studying the Social Security problem and planning to report back later this year. Any action that would adversely impact on the system prior to receiving the report of that commission would be premature.

It is most likely that many employers will terminate plans if this bill is passed. Small business already is extremely sensitive to the increasing role that government has been playing in the private sector and the burdens created by such statutes as ERISA through its various reporting and disclosure requirements, etc. This legislation is both ill conceived and improperly thought out as far as its impact on the private pension system. Rushed legislation is bad legislation. Throwing a wet blanket on the system that is already burdened now with the requirement of ERISA and a faltering economy will provide further impetus for employers to terminate plans or fail to initiate them in the first place. ERISA, one of the most complex pieces of legislation ever enacted, was ten years in the making. Tampering with the statute in a hurried and poorly thought out fashion is ill advised.

A far more profound effect of these changes will be unintended damage to the long term capital pool created by pension plans which is so vitally necessary to the economy. Plan terminations, cut backs and reduced new plan formation will drastically affect this pool at a time when its growth should be encouraged. Employers do not need any further excuses to terminate such plans and find other ways to provide benefits to their employees.

The major changes proposed in this bill deal with such things as the integration rules, the Code Section 415 limits on amounts that can be put into employee accounts or the maximum annual benefits which can be received from a plan, and the fractional factor that can be relied upon by employers that maintain more than one defined benefit and defined contribution plan. Reducing the 1.4 fractional rule to 1.0 may force may plans to terminate. The plans that will most likely be the first to go or be cut will be the types of plans administred by our Association, which tend to cover the rank and file employees on an equal basis with the higher paid. Employers who can satisfy the Code Section 410 (b)(1)(B) requirements will no doubt continue those plans that qualify under that section and terminate the others in order to bring their fractions down. In any event, even those that can continue to maintain two plans will have to amend then by reducing benefits. This also holds true for the integration rule changes since virtually every plan that is now integrated will have to be changed. We estimate that hundreds of the plans that we administer will have to be amended just because of the integration rule change alone. Reducing the 415 limits will require us to amend all four or our master plans.

An incredible amount of work and expense will be necessary by administrators of plans in order to submit thousands upon thousands of plans to the Internal Revenue Service, which is probably ill-equipped in terms of staff to handle the huge volumes of requests for determination letters that will no doubt be received. Hundreds of millions of dollars will be expended to comply, thus cutting tax revenue.

We fail to see the need for such changes now, considering the fact that the present federal law makes pension plans subject to strict antidiscrimination rules to prevent unfair treatment of rank and file employees versus key employees. The Congress, in 1974, established strict limits on the amounts that could be set aside for higher paid individuals in defined benefit and defined contribution plans and then established cost of living adjustments for the amounts statutorily established. A COLA is not unusual in light of the fact that the present federal employee system, which both Senators and Representatives are subject to, has such cost of living adjustments.

Rules such as the 1.4 rule allow many employees covered by both defined contribution and defined benefit plans to receive greater benefits than if they were covered by only one plan. Eliminating the 1.4 rule will adversely impact numerous plans. Profit sharing, thrift and savings plans encourage employees to save to supplement benefits from regular pension plans. Such plans are qualified only if the contribution formulas are not burdensome and there is substantial participation by the rank and file. Reducing the 1.4 rule is going to require reduction of the benefit and contribution formulas where two or more plans cover the same employees. Employees now eligible for more than one plan will be precluded from enjoying cash and deferred plans which have recently been encouraged by the Congress. The proposed altered limits would not significantly affect management, which would continue to benefit from unfunded, non-qualified deferred compensation plans. Many others employees are excluded from such plans.

There will be increased administrative cost and burdens which would be detrimental to the system. Records of pre and post effective date accruals would have to be maintained, plans and summary plan descriptions would have to be amended to reflect the lower benefit and contribution levels, much additional paperwork would be created and the expense of reprinting expensive booklets would put great strains on plans, particularly those of small employers. In addition, the extra expense represents increased tax deductions and thus may well wipe out a substantial portion of the supposed revenue enhancement.

The proposal to limit loans to key employees and to participants in cash and deferred plans is based on erroneous assumptions. Current law requires loans to be made on an arms length non-discriminatory basis. Loans to employees are appropriate plan investments. Prohibiting proper loans to key employees would influence many plans to eliminate loans to rank and file employees. Prohibiting loans in cash and deferred plans will undoubtedly discourage younger employees from participating in such plans, making it very difficult for employers to adopt them and meet the anti-discrimination rules.

With regard to the Social Security integration change, the proposal is highly complex and has not been carefully analyzed. All benefit formulas would have to be reexamined and amended. Benefit levels for all employees might well be reduced. The safe harbor rule being proposed is arbitrary and an inadequate measure of what an employer should be able to do. Employers should be permitted to choose which plan, if any (if they have more than one), should be integrated with Social Security.

Limitations on benefits and contributions will be a disadvantage to smaller companies in hiring and retaining talented employees. It is very difficult for small employers to compete for good people against the bigger companies in the first place.

In short, this legislation poses dire consequences for the private pension system and many small businessmen, as well as all employees. It has not been well thought out and we doubt whether its full impact is known, or can be known, without careful study. The legislative process should proceed very slowly. Rushing head long into changes to the private pension system, a very complex and highly finely tuned area, can only create disastrous results. A prime example of proceeding without all of the facts and knowing the impact can be seen in the Multiemployer Pension Plan Amendments Act of 1980, which is now wreaking havoc upon all types of businesses.

We urge rejection of this proposed legislation.

STATEMENT OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS

On behalf of over 500,000 small business owners, the National Federation of Independent Business (NFIB) submits testimony on H.R. 6410 for the hearing record.

Pension and profit-sharing plans, as well the tax rules which apply to them, comprise some of the most complex rules of the Internal Revenue Code. Starting in 1974 with the passage of the Employee Retirement Income Security Act (ERISA), and through several major "pension reform" bills plus literally reams of new regulations, the ability of small firms to deal effectively with the taxation of pension plans has greatly diminished. Just when it appears that small firms have had their confidence in the current system re-established (statistics reveal an expansion of the number of pension and profit-sharing plans), a new attack on the stability of the pension system is made through H.R. 6410.

Justification for this legislation is made under the pretext of equity, but have no illusions, no equity is intended and the severest impact of these changes will fall on the small business owner and his employees. H.R. 6410 will result in an increase in employer pension costs and a reduction of employee benefits, plus a large reduction in the number of employee benefit plans.

The Pension Equity Act has several provisions which will cause severe ruptures in existing plans while placing unjustified and unwarranted restrictions on many others. This legislation is offered at a time when even greater reliance on the private pension system is necessary due to the strain on the social security system. The President's Commission on Pension Policy strongly recommended actions which would provide new incentives for expansion of the private pension system to help relieve the strain on social security. Small business has a stake in the continued health of both the social security system and the private pension system because labor costs are of greater concern to labor intensive small businesses. Legislation of this magnitude should not be considered in a hasty manner and certainly not without extensive hearings. Discussions of the issues which cannot be accomplished in one day.

LIMITS ON CONTRIBUTIONS AND BENEFITS

A major perceived abuse of the pension system is the limits for defined contributions and defined benefit plans. Many have difficulty justifying substantially tax free pension plans for business owners who control professional corporations with very few participating employees. Treasury has sought repeadedly to carve out the professional corporations for punitive pension treatment. However, each attempt has failed because the rules never effectively delineate between professional corporations and closely held corporations, which are mostly small firms.

Current law has many effective rules for non-discrimination requirements which should effectively resolve many of the more egregious situations. a major cause in abuse of the system is, in fact, IRS' apparent incapability to adequately enforce these rules. Many other points need to be considered in light of these proposals which will have detrimental effects on the pension system—they are:

1. Lowering the limits for highly compensated individuals also reduces limits for employees and may cause reductions in the number of plans. A business owner will be charitable only to a point, since other vehicles for sheltering earnings are available.
2. Private pensions are a major source of private investment capital which has been utilized by many firms during our recent battle with high interest rates. It would appear counter-productive to close off these pools of capital to businesses.
3. The need to amend yet again a firm's pension plan—a very expensive process—will prove to be the final straw for many business owners, who will terminate their employee plans.
4. If small firms are forced to terminate their plans, large firms will be given an advantage in their ability to retain valuable employees by being able to protect employee benefits.

ANTILOAN PROVISIONS

The prohibited transactions provisions of ERISA shut down a major benefit of small firms who already had established pension plans other than self-employed H-R-10 or Keogh Plans. Borrowing from a firm's pension fund on a secured basis provided small firms with needed capital during critical periods. When borrowing from banks became difficult or impossible, small firms with pension funds were able to continue doing business, thereby protecting the jobs of their employees. In fact, employees themselves have found access to their pension funds through secured loans a helpful cushion during difficult times. However, ERISA and H.R. 6410 are more concerned with the termination of a plan and a business than with finding ways to maintain a plan and a business. Such loans on a secured basis should be allowed once more for small plans. It is worthwhile noting that ERISA never pointed to this as an abuse area. The rules simply were changed to conform to foundation rules.

SOCIAL SECURITY INTEGRATION

The problems within the social security system are of such potentially harmful magnitude that any attempts at piecemeal alterations to any aspect of the social security system should be immediately rejected. The National Commission on Social Security Reform is studying the social security system and its interaction with the private pension system. Premature decisions on changes become a very unwise alternative from a public policy perspective.

The changes in the integration rules will result in no benefit changes while increasing the employer's cost of maintaining a plan. This will act as a real disincentive to establishing new plans while generally promoting plan terminations.

RULES APPLICABLE TO PLANS COVERING SELF-EMPLOYED INDIVIDUALS AND EMPLOYEES OF PROFESSIONAL SERVICE CORPORATIONS

Arbitrary restrictions would be placed on partnerships and professional service corporations. Such restrictions will discriminate against individuals based on their legal form of organization. The service industry represents the only sector of our economy which currently displays and has significant potential for, any growth. There is simply no justifiable reason for this industry to be discriminated against within pension law. Certainly, this legislation provides no ability at all to differentiate between abusive situations and non-abusive situations. Instead a meat-axe approach is used.

CONCLUSIONS

Passage of any of the sections of H.R. 6410 is unwise and would prove detrimental to the private pension system. The four sections reviewed are those that would be particularly onerous to small business, but all of the provisions are unwise given the current state of private pensions and the social security system. We sympathize with the avowed goal of the legislation in attempting to establish an equitable system, but the approaches taken lack such capabilities without imposing grievious harm to a large part of the private pension system.

It is naive to suppose that the business owner's incentive is not a major reason for establishing a deferred compensation plan. However, this incentive benefits millions of employees who might otherwise have to depend on public pension welfare systems. Small business is labor intensive, which means that it is more severely impacted by changes which affect employment and employment costs. For this reason we have very strong concerns about taking hasty action. Due consideration must be given to all of the issues discussed before a decision is made.

Statement of Robert D. Lebenson, Executive Vice President, National Pension Service, Inc., White Plains, N.Y.

My name is Robert D. Lebenson and I am the Executive Vice President of National Pension Service, Inc. in White Plains, New York. My firm administers approximately 800 retirement plans, most of which are for quite small corporate employers. The average number of employees covered by our clients' plan is 8, which generally represents the total employment of the firm with sufficient service to qualify for entry. We have a relatively small number of larger plans, which to us means 50 to 200 employees. I am an Enrolled Actuary, and I manage a staff of 22 who are involved in our actuarial and administrative services.

I am also a member of the Pension Workshop of Greater New York, and my testimony is representative of and supported by the other members of that group. The Workshop is an informal association of organizations similar to my own, dealing primarily with a small plan clientele. The fifteen members of the Workshop collectively administer a total of approximately 10,000 retirement plans.

I would like to testify in strenuous opposition to the passage of HR-6410. In doing so, I would like to initially concentrate on my opposition to Section 4 of the Bill, which would modify the existing provisions for integration of private pension plans with Social Security. My opposition to that Section of the Bill, which particularly relates to the provisions effecting Defined Benefit plans, is representative of my feelings toward the Bill as a whole, which include not only general opposition, but also extend to dismay at the lack of understanding of the existing private pension system displayed by the drafters of this legislation.

SECTION 4—CHANGES IN INTEGRATION RULES

It may come as a surprise to proponents that I do not base my opposition to the integration changes upon an argument that it will require increases in benefits for all low paid employees, thereby increasing private pension plan costs. On the contrary, a preliminary study which I have performed on a representative group of 140 employees, all earning not more than the Social Security wage base, indicates that were those employees covered by a Defined Benefit offset plan, the pensions of 60 percent of the employees from that plan would actually be reduced by the provisions of the Bill. (The details of that study appear on the following page.) While the reduction of benefits for low paid employees is not, I suspect, an objective of the sponsors of this Bill, the fact that it would be the result of the Bill is indicative of their lack of understanding of how private pensions operate, which I referred to earlier.

COMPARISON OF PENSION AMOUNTS FROM 50 PERCENT OFFSET PLAN EXISTING LAW VERSUS PROPOSED BILL (H.R. 6410)

Age at hire	Current age	Current salary level				
		$10,000	$15,000	$20,000	$25,000	$32,700
25	25	Higher	Higher	Higher	Higher	Higher.
25	30	do	do	do	do	Do.
30	30	do	do	do	do	Do.
25	35	do	do	do	do	Do.
30	35	do	do	do	do	Do.
35	35	do	do	do	do	Do.
25	40	do	do	do	do	Do.
30	40	do	do	do	do	Do.
35	40	do	do	do	do	Do.
40	40	Lower	do	do	do	Do.
25	45	Higher	do	do	do	Do.
30	45	do	do	do	do	Do.
35	45	Lower	do	do	do	Do.
40	45	do	Lower	do	do	Do.
45	45	do	do	Lower	do	Do.
25	50	do	do	Higher	do	Do.

COMPARISON OF PENSION AMOUNTS FROM 50 PERCENT OFFSET PLAN EXISTING LAW VERSUS PROPOSED BILL (H.R. 6410)—Continued

Age at hire	Current age	Current salary level				
		$10,000	$15,000	$20,000	$25,000	$32,700
30	50	do	do	do	do	Do.
35	50	do	do	do	do	Do.
40	50	do	do	do	do	Do.
45	50	do	do	do	Lower	Do.
50	50	do	do	do	Lower	Lower.
25	55	do	do	do	Higher	Higher.
30	55	do	do	do	Lower	Do.
35	55	do	do	do	do	Do.
40	55	do	do	do	do	Lower.
45	55	do	do	do	do	Do.
50	55	do	do	do	do	Do.
55	55	do	do	do	do	Do.

Higher—indicates a greater pension from the plan under existing law.
Lower—indicates a greater pension from the plan under the proposed law.

Summary: 83 out of 140 employees have higher pensions under existing law then under proposed bill.

My reason for opposition to the proposed integration system for Defined Benefit plans is that in several respects it is not a rational method for coordinating private plan benefits with Social Security. Among its deficiencies in this respect are included the following:

(1) It mistakenly attempts to equate Social Security benefits with Social Security contributions, as though Social Security were a Defined Contribution pension plan. The fact is that Social Security is effectively a Defined Benefit pension plan, where the benefits are fundamentally computed as a percentage of salaries earned up to the taxable wage base.

The current system of integration recognizes this fact, and therefore, results in generally close correlation of benefits between Social Security and the private plan. The proposed system does not recognize this fact and therefore, produces significant distortions, which in many cases penalize most heavily those employees whom I suspect the Bill is attempting to help.

(2) An example of such a distortion, which is caused by the erroneous approach to calculating Social Security benefits referred to above, is the severe penalty which is imposed upon low paid employees with long service with a single employer. One of the objectives that has been raised in the past by opponents of the existing method of Social Security integration, is that low paid employees can be "integrated out" of the private plan. This occurs when the entire percentage of salary benefit level of the plan is equalled by the participant's Social Security benefit, and in fact generally happens only where a plan provides a percentage benefit level of 30 percent or less.

Under the proposed legislation, many long service, low paid employees would find themselves "integrated out" of company pension plans, even where benefit formulas are at the level of 50 percent or higher. In fact, an employee with 40 years of service at the same company at retirement, whose pension plan calls for 75 percent of compensation, might have to earn more than $45,000 per year in order to obtain any benefit whatsoever from the company's plan. This is surely indicative of the severe bias that exists in the Bill against long service employees.

The chart on the following page illustrates each of these two problems caused by the proposed Bill.

(3) Unlike the present system of integration, the Bill ignores the fact that the Social Security benefit formula is constructed in a "stepped-down" fashion. This formula provides a Social Security retirement benefit of approximately three times the percent of the lower half of taxable wages as it does compared to the upper half of such wages. For example, for 1982 the benefit formula is (effectively) 42 percent of the first half of Social Security wages, and only 15 percent of remaining wages.

INTEGRATION PROBLEMS FOR LONG SERVICE EMPLOYEES

I. OFFSET PLAN BENEFIT FORMULA REQUIRED UNDER PROPOSED BILL—TO AVOID "INTEGRATION OUT" OF THE PLAN—FOR EMPLOYEE EARNING $32,700 OR LESS

[In percent]

Current age	Years of service at age 65		
	40	35	30
25	105	N/A	N/A
30	93	76	N/A
35	75	66	54
40	58	53	47
45	44	41	37
50	33	30	27
55	24	22	19

II. SALARY REQUIRED FOR 40 YEAR SERVICE EMPLOYEE—TO AVOID "INTEGRATION OUT" OF 75 PERCENT OFFSET PLAN

Current age	Under existing law	Under proposed bill
25	$9,472	$45,840
30	9,472	40,432
35	9,312	32,800
40	9,040	25,456
45	8,688	19,232
50	8,304	14,432
55	8,000	10,608

This formula is unrelated to the employer tax formula, which is a single uniform percent of all covered wages. It is therefore illogical, as well as mathematically incorrect, to attempt (as the Bill does) to equate contributions and retirement benefits.

The result of this inconsistency would be discriminating against employees in the $16,000 to $32,000 bracket, whose retirement income as a percentage of compensation would be lower than that of individuals earning either more or less than they do.

(4) My understanding of the Bill, as amplified in the explanation presented by Congressman Rangel to the House of Representatives, leads me to believe that it would inflict a severe penalty upon the last employer that an employee works for in his career. Since the vast majority of private pension plans base benefits upon a "final average pay" formula, that final employer is already saddled with the greatest burden of providing an employee's retirement income, simply because the final pay is also likely to be the highest. The operation of the Bill would exaggerate this burden, since the last employer would receive the least amount of credit for Social Security taxes which he pays on the employee's behalf. This in turn, would lead to an inconsistent and unfair situation in which the final employer, who already has the least amount of time in which to fund the employee's benefit, actually is forced to provide a higher percentage of pay as retirement income to an employee than does a previous employer, whose Social Security contributions on the employee's behalf have been identical.

An example is contained in the chart on the following page. It illustrates the retirement benefits that would be available to an employee who worked for ten years of his career for each of four employers, all of whom sponsor identical Defined Benefit plans. The employee progresses in income through the four employers' plans, and the accrued benefit available at retirement under present law and under the proposed Bill is compared.

COMPARISON OF ACCRUED RETIREMENT BENEFITS

Assumptions: Applicable to all three scenarios

(a) Employee starts work at Employer 1 at age 25, and continues for 10 years. Commencement at Employers 2, 3, and 4 is at 35, 45, and 55.

(b) In each case, employee's average earnings are as follows: Employer 1—$10,000; employer 2—$15,000; employer 3—$25,000; and employer 4—$32,700.

(c) Within each scenario, plans of each sponsor are identical. (i) Immediate eligibility; (ii) Full vesting within 10 years of service; and (iii) Accrued benefits based on "pro-rata rule."

SCENARIO 1: ALL EMPLOYERS' PLANS ARE 60 PERCENT OFFSET FORMULA WITH 25 YEARS SERVICE REQUIRED FOR FULL PENSION

	Accrued monthly benefit payable at age 65	
	Under existing law	Under proposed law
From employer 1	$44	0
From employer 2	105	$27
From employer 3	295	294
From employer 4	454	561
Total	898	882
Percent from employer 4	51	64

SCENARIO 2: ALL EMPLOYERS' PLANS ARE 75 PERCENT OFFSET FORMULA WITH 25 YEARS SERVICE REQUIRED FOR FULL PENSION

	Accrued monthly benefit payable at age 65	
	Under existing law	Under proposed law
From employer 1	$75	0
From employer 2	167	$90
From employer 3	420	420
From employer 4	618	724
Total	1.280	1,234
Percent from employer 4	48	59

SCENARIO 3: ALL EMPLOYERS' PLANS ARE 75 PERCENT OFFSET FORMULA WITH 30 YEARS SERVICE REQUIRED FOR FULL PENSION

	Accrued monthly benefit payable at age 65	
	Under existing law	Under proposed law
From employer 1	$75	0
From employer 2	167	$90
From employer 3	350	350
From employer 4	515	604
Total	1,107	1,044
Percent from employer 4	47	58

It is interesting to note that under the proposed Bill, in each scenario a significantly higher portion of the employees' total pension comes from the plan of the final employer, who has the least time in which to fund it. Also of particular interest is that the total pension of the employee (who could hardly be considered highly paid) is reduced under the provisions of the Bill.

I think it can be clearly seen that this exaggeration of the pension cost burden upon the final employer will lead to defacto discrimination against older workers who wish to change jobs, and severe hardship for individuals approaching age 65 who need to secure new employment.

I think it is fair to say that the list of inconsistencies which I have just enumerated should cast a significant element of doubt upon the effect of the integration changes upon plan benefits. In fact, a similar level of inconsistent and illadvised considerations pervade all of the other Sections of the Bill, which are similarly framed without a clear understanding of the objectives or the operation of the private pension system.

In addition to my opposition to the integration provisions of the Bill, I would like to make the following comments in opposition to several other Sections of the proposed legislation.

SECTION 2—REDUCTIONS IN CONTRIBUTION AND BENEFIT LIMITATIONS

The imposition of these reduced limits will have a significantly more negative effect upon lower paid employees (particularly those of smaller businesses) than it will upon the executives or stockholders, which it presumably is intended to limit. This is simply because the individuals who are directly impacted by this restriction are also the same individuals who will be responsible for the provisions of the company's retirement plan. In the practical world, these individuals will be virtually certain not to provide a retirement plan for rank and file employees which provides a higher percentage of compensation (either as a benefit, or as a contribution) than it does for those executives themselves.

For example, if the executives of a corporation receive salaries of $200,000 a year, it is quite likely that under present rules they would adopt a Defined Benefit plan providing 70 percent of compensation as a pension benefit (or perhaps higher, taking into account future cost of living increases in the dollar limitation under present law). Under the proposed Bill, since their own pensions would be restricted to 45 percent of their salaries, ($90,000 as a percentage of $200,000), it is highly unlikely that the pension plan would exceed that 45 percent level. The more highly paid the executives of the firm are, the more drastic the reduction in the level of benefits provided under the plan would be. This reduced level of benefits would, unfortunately, apply to all of the employees of the company, not only the executives.

It is my belief that such a reduction in retirement income (for example from 70 percent to 45 percent) will impose a far more significant hardship on a lower paid retiree than will the reduction from $136,000 to $90,000 imposed on the executive. It should be noted that this reduction will, in practical application, not only extend to the formation of new plans, but to the levels of benefits under existing plans.

It is my further opinion that any legislation which has the effect of reducing private pension plan benefits for lower paid employees will ultimately (if not sooner) create an additional burden for the already over-burdened Social Security system.

In addition to my concerns regarding the effect of the Bill upon lower paid employees, I also believe that it represents unwarranted discrimination against higher paid individuals. Such discrimination should not exist, particularly in a private pension system which is entirely voluntary on the part of sponsoring employers. It appears to me to be an illadvised attempt to legislate some sort of social policy via the means of tax policy.

Additionally, both in its rollback of the dollar limitation to $90,000 and its prohibition against future cost of living increases, the proposal totally ignores the realities of inflation. The current dollar limit of $136,425 is simply the result of the changes in consumer prices that have occurred since the passage of ERISA. Do the sponsors of the Bill propose to legislatively rewrite history, and reestablish that rate of increase at 2.3 percent? (I think if the answer were yes—which, of course, it is not—I would happily accept this provision of the Bill). Furthermore, the restriction on future increases, while presumably aimed at the highly paid, will very rapidly have the potential for impact on individuals with moderate incomes. At a rate of inflation of only 5 percent, for example, within 20 years the dollar limit will apply to employees earning at the level of the Social Security wage base.

Finally, I find it interesting to note that the new restrictions that would be imposed by the Bill, in maximum benefits, early retirement, and cost of living increases, do not apply to the various retirement plans of Federal employees.

SECTION 3—CHANGES IN RULES GOVERNING PARTICIPANT LOANS

I cannot imagine any intelligent reason for the existence of this Section within the Bill. Rules are set forth in ERISA which both sanction and carefully govern the area of loans by a qualified plan to its participants, and I do not know of any abuses of these rules which exist. The rules provide careful safeguards of the interests of the participants in the plan who do not choose to make loans. In many cases, the rate of return the plan receives on such loans is in excess of that which it receives on its general investments.

Once again, this Section seems to be an attempt to "penalize" the stockholder and executive participants, particularly of smaller business organizations. And once again, the true victims of this "penalization" will be the rank and file participants in the plan. Once again, the condition will exist wherein, if the stockholders and executives are prohibited from making loans from the plan, they will rescind the loan provisions from the plan which extend to all of its other members. This will remove from the average worker a source of funds which has previously been available to him to meet emergency financial needs, which in most instances has been more valuable to the average worker than to the executive. In many cases, in fact, such loans have been the only source of emergency funds for lower paid individuals.

Additionally, many smaller businesses may be deterred from adopting new pension plans if rules prohibiting or deterring borrowing come into effect. While few small businesses adopt plans with the intent of using them as a vehicle for borrowing, many small companies (particularly in cyclical industries) will be reluctant to make the long term commitment required to maintain a qualified plan without the ability to include loan provisions.

While this Section of the Act is (presumably) targeted at the plans of smaller businesses, it will also have a negative effect upon larger plans, even if those plans retain their borrowing provisions. This is because in such plans many thousands of employees may be swept into the category of the "highest paid 15 percent" and thereby also be deprived of emergency borrowing ability.

Finally, there is no revenue effect which can be perceived from the restrictions contained in this Section.

SECTION 5—REDUCTIONS IN CERTAIN DEDUCTION LIMITS

This Section is essentially an extension of the philosophy of Section 2 of the Bill with further restrictions applying to selected individuals in certain professional fields. Consequently, all of my comments in opposition to Section 2 apply also to Section 5, with the only exception being that its negative effects would be more severe.

In addition, there are two further arguments against this Section which I would like to state. First, I believe that this Section represents a totally unwarranted and unfair measure of discrimination against particular occupational classes. I admit that I am self-interested to the extent that my occupation is included. However, I do not see what possible justification exists for prohibiting an individual who has decided upon a career in medicine, accountancy, law (or actuarial science) from receiving the same level of retirement benefits that he could have obtained in countless other occupations.

Secondly, it is my belief (supported by historical evidence) that the genuinely high income earners in these professions will seek and obtain other forms of tax shelters than the qualified plan if these limitations are imposed. Such other activity will totally deprive their employees from receiving retirement benefits of any kind, and additionally, the alternate shelters themselves will in all probability be of a less productive nature with respect to capital formation than would have been investment in a qualified plan fund.

GENERAL COMMENTS IN OPPOSITION

While I have concentrated on certain individual Sections of the Bill, I would like to close by stating that I equally oppose all of the other Sections. In my opinion, this measure would have a seriously detrimental impact upon the private pension system in America, and upon the retirement income and security of millions of individuals.

Among the effects that the passage of this legislation would have are:

(1) The termination of many thousands of existing pension plans, together with a significant reduction in establishment of new plans.

In my judgement, the level of plan termination will significantly exceed even that which was experienced in the years immediately following ERISA. Additionally, the Bill will have an even more disastrous impact upon new plan establishment. This will result, not only because of the several instances of removal of incentives to create a new plan, but also because of the Bill's totally contrary approach to the private pension system, as compared to recent governmental attitudes. This appearance of total instability in the approach of government toward private pensions will inevitably result in massive loss of confidence in the system. Finally, and on a more practical level, the professionals in the pension field (e.g. attorneys, actuarys, etc.) will not have the time to supervise the establishment of new plans for several years; they'll be too busy "picking up the pieces" for old ones.

(2) A serious reduction in the formation of capital represented by private pension funds and contributions which is so vitally needed to achieve economic recovery.

This will result directly from the plan termination activity, and new plan formation "non-activity," referenced in the preceding paragraph. I believe it is also important to point out that the encouragement of capital formation has been historically one of the primary reasons that previous Congresses, in their wisdom, have established the tax system which governs pensions. It is also appropriate to note that, contrary to certain currently-expressed thoughts, neither the contributions to, nor investments of, qualified plans are "tax-free"; they are merely tax deferred. All pension funds are ultimately taxed, upon distribution to participants or beneficiaries. In the interim, while such funds are temporarily tax sheltered, they form a major ($400 billion) pool of investment capital to support America's economic needs.

(3) A particularly negative impact upon the plans of smaller businesses, which seem to be the direct "target" of the proposed Act.

It is vital for Congress to recognize that the small businessperson in America should be encouraged, rather than discouraged, in every way possible. Over 65 percent of the new jobs created recently in the country were the result of the business activity of companies employing 20 or fewer people. A vital need of small business, in order to compete in the labor market (against the perceived "security" of larger organizations) is the ability to maintain a competitive program of employee benefits. This ability should in no way be imperiled or impeded.

(4) The potential of placing additional hardship on the already over-burdened Social Security system, to replace the required retirement income for employees of firms who terminate their private plans.

Nowhere in this testimony have I commented on the expected revenue that the sponsors of the Bill claim will be derived, simply because I have seen no published estimates at this date. (I understand they will be available by the time of the hearing.) However, even without this information, I cannot imagine that the temporary gain realized in tax revenue will ever approach the ultimate cost of passage of this legislation.

(5) The imposition of extensive and unnecessary costs upon both sponsors or private plans, and the related governmental agencies, to implement conformity to the Acts provisions.

In many instances, the one-time cost to a business of implementing the required changes (even to a plan to which the impact is minimal) will be sufficient to cause the termination of the plan. This does not even consider the additional cost of administration, which will be required because of the modification of computer and manual systems and will have to be amortized over future years. It is my estimate that the total one-time cost of modifying and amending plans to incorporate the integration changes alone will be minimally one billion dollars.

This, of course, does not include the cost to the Federal Agencies of promulgating new regulations and rulings, reviewing and approving (those plans which choose to continue), processing the thousands of plan terminations and guaranteeing the benefits where necessary of terminating Defined Benefit plans.

While on the subject, it is appropriate to point out that nearly eight years after the passage of ERISA a substantial number of regulations remain to be finalized. This Bill, while less lengthy in words, is no less complex or encompassing, and its effective dates are even more unrealistic than were those of ERISA. I seriously doubt whether, even if a single provision of this Bill were desirable (which is not the case), implementation by either the government or the private sector could occur according to "schedule."

One final comment about implementation costs is in order. It will probably be claimed by proponents of the Bill that the opposition that I and others in the pension industry express is solely based on self-interest. This is not the case. The fact is the billion dollars of costs for conforming plans to the integration rules, and the other millions or billions expended with relation to other Sections, would primarily be directed toward pension professionals like myself. In other words, passage of this Bill would be a "bonanza" for those of us, whose income is primarily on a fee-for-services basis. However, despite the economic gain which I would foresee, I still totally oppose the Bill for all the reasons expressed above.

For the past several years, the government has intelligently recognized, through the President's Commission on Pension Policy, and through legislation such as portions of ERTA, that Federal programs cannot solve the retirement income needs of our population by themselves, and that the private system must be strengthened and encouraged. This proposed legislation would reverse that trend, and I therefore, believe it is not in the best interests of our nation. I urge you to oppose its passage.

STATEMENT OF KATHY WILSON, NATIONAL CHAIR, NATIONAL WOMEN'S POLITICAL CAUCUS

The National Women's Political Caucus applauds Representative Rangel for his initiative in introducing H.R. 6410, the Pension Equity Tax Act of 1982, and the House Ways and Means Committee for scheduling this prompt consideration of the bill. The National Women's Political Caucus is a nationwide, multipartisan organization with 60,000 members and 300 state and local caucuses. The purpose of the NWPC is to obtain equal representation of women in elective and appointive office and to speak out on issues of direct concern to women.

We are particularly pleased that the Committee will examine the problem of integration of social security benefits with private pension benefits. Virtually all workers earning under the social security wage base figure—32,400 in 1982—are hurt under integrated plans. This means that women are disproportionately hurt. In 1980, according to the Women's Bureau at the Department of Labor, just 1 percent of all women with income earned over $25,000 annually.

Integration of social security and pension benefits is a serious roadblock in acquiring adequate retirement income for women, and the Rangel proposal offers a common sense first step for improving the situation.

This is a time of great concern over the federal budget and federal spending. The huge cuts in social programs and human services have a harsh and disproportionate impact on women because of our second-class citizen earning power. It is only right that the tax expenditure side of the budget be examined as well. In 1983, estimates show that tax breaks for company contribution to pension plans are the highest single tax loss totaling over $27 billion. (U.S. News and World Report, March 22, 1982, page 85). Internal Revenue Service rules require that qualified pension plans are nondiscriminatory in the distribution of benefits to the highly paid/employers and lower paid/employees. The federal government must not subsidize or sanction retirement plans which are blatantly unfair to lower-earning employees while providing a healthy tax shelter for employers.

The National Women's Political Caucus believes that it is possible and necessary to tighten the rules for qualified pension plans and social security integration to insure nondiscrimination, and, as Representative Rangel stated in introducing his bill, include "the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans."

WOMEN AND PENSIONS EQUAL INADEQUATE RETIREMENT BENEFITS

In reviewing current pension policy, we urge the Committee to consider the impact of those policies on women as a class of citizens and to remember the poverty of older women in America today.

Of all the aged poor households in this country, 72 percent are made up of unmarried women—those divorced, widowed or single. Eighty-one percent of our women citizens over age 65 not living with relatives have incomes below poverty level, compared with 19 percent of the men.

In 1978, 11.4 percent of Americans lived below the poverty line. For women over age 65, the poverty rate was 16.7 percent.

Older women live in poverty because they are unable to secure adequate retirement incomes—either as workers or spouses. In 1979, approximately 31 percent of women workers were covered by a pension plan as compared to 50 percent of men workers. Of those covered, just 41 percent of the women had vested benefits, compared to 51 percent of the men. The reason for this is women's unique employment pattern due to women's role and status in society.

First, the types of jobs in which women workers are concentrated are more likely to have no pension coverage. Over half of all working women are employed in the fields of sales and service—the occupations with the fewest number of pension plans. To some extent companies are allowed to provide pension plans for some types of employees while excluding others. Often those positions excluded are those with high proportions of women.

Even when a woman worker is covered by a pension plan it is unlikely she will vest her benefits.

Participation requirements for pension plans disproportionately exclude women. Under the Employee Retirement Income Security Act (ERISA), employers are not required to cover employees until they are 25 years old. Yet the age group with the highest labor force participation for women is from 20 to 24 years. About 68 percent of all women in this age bracket are employed—more than in any other age bracket. To fail to count these years is a severe disadvantage to women in accumulating pension benefits.

Also, women are more likely to work part-time or part-year, an so may not meet ERISA standards for the "year of service" needed for pension credit. ERISA defines a year of service as at least 1000 hours—which is 20 hours per week year round or six months at full time—in a 12 month period. If a woman works less than that, she may get no credit for that work. About 70 percent of all part-time jobs are now held by women.

The pattern of low job tenure for women has a serious negative effect on their ability to accrue vested pension benefits. ERISA does not require vesting more rapidly than 10 year cliff or 4/40. Yet statistics reveal that over half of all full-time workers covered by private pensions have not been at their present jobs for over 10 years. A disproportionate number of those with short job tenure are women. The median number of years on the job for women in 1978 was 2.6 compared to 4.5 for men. Almost 85 percent of women had been at their jobs less than 10 years. For workers in the 55–64 age bracket, the median number of years on the present job increased to 14.6 percent for men and 8.5 percent for women—women workers still falling below the ERISA standard for vesting.

For the most part, women are stuck in low-paying, dead-end jobs. With large numbers of women entering and reentering the labor force and with continued wage discrimination and sex segregation in the work place, we can expect this pattern of short job tenure to continue. Also, in these times of economic trouble, women are most likely to be victims of the "last hired, first fired" syndrome.

During their working career, women often stop paid employment in order to raise children and fulfill traditional family responsibilities. This can seriously impair women's ability to gain economic security in retirement. Such breaks in service effect opportunities for vesting, can limit the total pension credits accumulated, and possibly force a woman to forfeit all previously earned credits.

Because of all these factors—lack of availability of pension plans in occupations in which women are concentrated, pension plan participation rules, slow vesting schedules, and breaks in service—it is unlikely that a woman worker will be able to gain her unforfeitable right to her accrued pension benefits.

And because women still earn just 59 cents for each dollar earned by the average man, and women on the average have fewer total years of paid employment than men, even where a woman worker is covered by a pension plan and qualifies for her vested right to those benefits, the amount of the pension is unlikely to provide security in retirement. The Census Bureau reports that in 1979, the average pension benefit for men was $3,657, compared to $2,186 on average for women—a difference of $1,471. In 1981 this gap actually increased, the average for men being $4,103 and for women $2,375—a gap of $1,728.

In sum, women in the labor force are less likely to be covered by pension plans, less likely to ultimately receive pension benefits, and typically receive lower benefits than men.

Because pensions are generally thought to be the "property" of the wage-earner, women also lose out as spouses and survivors.

ERISA requires that most private pension plans offer joint and survivor benefits—an annuity of at least 50 percent of the pension benefit paid to a widow or widower. But the restrictions on these benefits are limiting to the extent that few women—an estimated 10 percent—actually receive survivor benefits. This is particularly crucial for career homemakers who have few options for gaining a retirement income in other ways.

The election of joint and survivor benefits results in the pension benefits being reduced during the wage-earner's lifetime, causing many workers to waive the option. The option can be waived without the consent or notification of the spouse.

ERISA places other stipulations on the joint and survivor annuity so that a number of circumstances must be met before the benefit is payable. The worker and spouse must be married one year before the start of the pension and one year before the worker's death. The worker cannot die before becoming eligible for the survivor benefit. And the worker cannot die within two years of electing the joint and survivor option between early and normal retirement age. The result is that many widows—expecting and counting on the benefit—find it does not exist.

In the case of divorce, ERISA does not expressly provide for ex-wives and state domestic relations courts have varied on this issue.

Many reforms in the pension system are needed to make it truly equitable. Accelerated vesting schedules are the key to improving women's opportunities to acquire adequate pensions in their own right. Changes in participation requirements, breaks in service rules, portability, integration with social security, the use of sex-based actuarial tables, better coverage for widows, divorced women and homemakers is also needed.

Congress now has before it a bill that begins to address the serious problem of women and pensions—the Economic Equity Act of 1981, S. 888 and H.R. 3117. Portions of this bill, which address a variety of women's economic needs, are designed to adjust the current pension system to better fit women's work patterns and women's needs. Included in the bill are provisions to:

Lower the minimum age for participation in private pension plans for 25 to 21, to include the years most women are in the workforce to help more women vest their benefits and gain more total years of service.

Allow company approved maternity or paternity leave to count as service for vesting and participation accrual, so that mothers and fathers who take time off for family responsibilities are not penalized.

Require the written consent of both spouses to waive survivors benefits.

Require the payment of the survivors benefit if the participant is vested but dies before retiring.

Eliminate the two-year waiting period rule for payment of survivors benefits for individuals who die from non-accidental causes.

Establish the pension as a legitimate property right of the marriage, divisable on divorce or for child support or alimony payments.

The National Women's Political Caucus along with many national women's and civil rights organizations fully supports the Economic Equity Act as a first step toward rectifying the existing inequities in the pension system.

INTEGRATION OF SOCIAL SECURITY AND PENSION BENEFITS

Integration of social security and pension benefits allows employers to offset social security benefits from a pension. In essence, the employer takes credit for social security taxes when figuring a worker's pension. Because social security is weighted to help lower-earners, integration can—and often does—take a large portion or all of the worker's benefit. Because of complicated rules and formulas, the vast majority of workers do not know their pension benefits will be integrated and how that integration will affect the size of their retirement income. They may work for years assuming they are acruing benefits that will provide economic security when they retire, when in fact, the benefits due them go to subsidize the pensions of the highest paid.

Social security was intended and designed to supplement personal savings and private pensions, not to be sufficient as the sole retirement income. In today's economy, it is clear that the average social security benefit—now about $4,800 per year for a retired worker—is not enough to live on. In fact, that is about one-half today's cost of living in most U.S. cities.

The current systems of allowing qualified pension plans to integrate social security benefits undermines the national goal of encouraging pension plans for all workers. The National Women's Political Caucus questions whether any qualified plan should be allowed integration and requests that this Committee further investigate this issue in the near future.

H.R. 6410 takes a small step toward limiting the integration of benefits by allowing the employer to subtract only the social security benefits directly attributable to the employer's social security contributions for that employee. This would prevent the amount of social security benefits contributed by previous employers from being included in the integration, as well as social security "insurance." The proposed alternative "safe harbor" should also help limit the impact of integration. The Rangel proposal is really only a small step toward a solution for the problem of integration of benefits, but it is a step in the right direction.

Many reforms and careful consideration will be necessary to make the pension system truly equitable for women and all rank-and-file workers. I thank the Committee for the opportunity to include the perspective of the National Women's Political Caucus in your examination of this important bill.

NORTHERN TRUST CORP.,
Chicago, Ill., June 4, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: The Northern Trust Company and its affiliates have approximately 4,000 full time employees, all of whom participate in The Northern Trust Company's defined benefit plan and, after one year of service, in The Northern Trust Company's defined contribution plan. The proposals of H.R. 6410 regarding the reduction of Code Section 415 limitations have the potential of affecting as many as 65 percent of those employees, approximately 49 percent of whom are being paid under $31,000 annually. This result will occur with respect to The Northern Trust Company's plans primarily by reason of the reduction of the combined defined benefit and defined contribution fraction from 1.4 to 1.0, but also to some extent because of the reduced dollar limits of the Bill and the elimination of the cost-of-living adjustments to those dollar limits.

The attached table, which is a synopsis of more extensive data provided to us by our actuaries, suggests how the reduction of the Section 415 limitations may affect those employees whose salaries range from $12,000 to $30,999 annually—approximately 60 percent of our total full time employees. The calculations are based upon present salary levels and years of service projected until normal retirement date under our plans, age 65, using actual dates of birth and dates of hire. Certain verifiable assumptions were made on past salary increases but no assumptions were made on future salary increases as prescribed by the regulations under Section 415 even though salary increases are inevitable and would result in a greater number of employees being impacted by the proposals. The table illustrates that the proposals could result in benefit reductions for 73 percent of all employees with current salaries of $12,000 to $12,999, and for 74 percent of all employees with current salaries of $13,000 to $13,999. Similarly, the proposals could adversely affect 80 percent of those with current salaries of $16,000 to $16,999, 93 percent of those with current salaries of $20,000 to $20,999 and 98 percent of those with current salaries of $30,000 to $30,999. The table illustrates that over 80 percent of all employees in the salary ranges of $12,000 to $30,999 or 49 percent of the total number of our employees could have benefit reductions under our plans if the proposals are enacted.

For many years, Congress has encouraged employers to establish private retirement plans for employees by use of tax incentives to the employer. There is no assurance that an employer would be able to continue to provide those retirement benefits if tax benefits to the employer are eliminated in view of the costs of providing retirement benefits with after-tax dollars. We have traditionally sought to provide our employees with financial security during retirement through generous retirement benefit programs based more on perceived needs of our employees than on tax incentives which are available under the Code, although tax considerations have become a factor in plan design. Despite our concern for the welfare of our retired employees, if the proposals are enacted we will have to reconsider seriously the cost effectiveness of our retirement plans as presently constituted and may well decide that it will be necessary to reduce benefits in the future.

An amendment to our plans to provide a reduction of benefits for possibly 65 percent of our staff will not only have a negative impact from an employee relations standpoint, but will also cause the affected employees to raise questions about the appropriateness of the legislation. To the extent that we do not adequately provide retirement benefits for our employees, it seems inevitable that those employees will become more dependent upon government sponsored programs. At a time when the programs of the public sector are strained financially, it is difficult to perceive the rationale of discouraging the private sector from offering those benefits. Certainly, the proposals are a disincentive for us to continue to provide the same retirement benefits we have offered in the past.

The Northern Trust Company is trustee of a number of employee benefit plan trusts, the plan sponsors of which may also be impacted by the proposed legislation. Those plan sponsors have already experienced considerable increases in costs of maintaining retirement plans as a result of the enactment of ERISA. Indeed, some plan sponsors preferred to eliminate retirement benefit programs as a result of those increased costs. The enactment of H.R. 6410 only a few years after the massive legislative changes brought about by ERISA is likely to exacerabate the concern of plan sponsors about the cost effectiveness of maintaining retirement plans for employees. Compliance with the proposals, particularly those relating to integration of plans with Social Security, will be extremely complex and expensive because of the necessity to restructure and requalify plans. At a time when economic conditions are difficult for many employers, those additional costs may be seen as unjustifiable. Furthermore, there does not appear to have been any study done on the federal revenue impact of the proposals relating to the Code Section 415 limitations. It does not appear that there will be any appreciable federal revenue gain in the near future if those proposals are enacted, but it does seem likely that many plan sponsors will amend their retirement plans to reduce the ultimate benefits received by employees upon retirement. The cost to the employees would seem hardly to justify any federal revenue gain which may eventually be received.

The employees of The Northern Trust Company and other plan sponsors for whom we act as trustee already bear a significant part of the burden of maintaining government retirement programs. In our opinion, it would be unjust to reduce the retirement benefits which might otherwise be earned by those employees in order to obtain increased federal revenues of an indeterminate amount to be garnered at an uncertain time in the future. The emphasis of most retirement plans is to provide a secure retirement for employees and not to obtain a tax deduction for the plan sponsor. The proposals found in H.R. 6410 could result in reduction of those benefits, discourage plan sponsors from continuing to provide benefits, and place a greater burden upon government programs such as Social Security.

We sincerely hope that the House Ways and Means Committee will seek to obtain other statistical information from plan sponsors such as ourselves to determine the impact of the proposals on employees covered by defined benefit and defined contribution plans, particularly those employees who may be considered as lower paid. Prior to the enactment of ERISA, The Northern Trust Company actively participated in deliberations regarding the Section 415 limitations, and we have now compiled considerable data not reflected in the attached table which illustrates the widespread effect on retirement benefits under our plans if the proposals are enacted. Both as a plan sponsor and as trustee of a significant number of employee benefit plans, we would be willing to provide the Committee with whatever information we have available and is not privileged to assist in determining how these proposals may affect the private pension system. The analysis we have made regarding our own retirement plans leads us to conclude that enactment of legislation which could result in reduction of benefits for such a significant number of our employees, including the lower paid, is inappropriate.

Very truly yours,

PHILIP W. K. SWEET, JR.,
Chairman of the Board.

Salary range	Number of employees whose benefits may be reduced	Percentage of all employees in salary range whose benefits may be reduced	Percentage of all employees
$12,000 to $12,999	232	73	5.7
$13,000 to $13,999	218	74	5.4
$14,000 to $14,999	182	64	4.5
$15,000 to $15,999	224	76	5.5
$16,000 to $16,999	143	80	3.5
$17,000 to $17,999	210	88	5.2
$18,000 to $18,999	103	82	2.5
$19,000 to $19,999	108	86	2.7
$20,000 to $20,999	94	93	2.3
$21,000 to $21,999	66	93	1.6
$22,000 to $22,999	56	100	1.4
$23,000 to $23,999	36	90	.9
$24,000 to $24,999	63	91	1.6
$25,000 to $25,999	46	90	1.1
$26,000 to $26,999	40	91	1.0
$27,000 to $27,999	72	96	1.8
$28,000 to $28,999	35	100	.9

Salary range	Number of employees whose benefits may be reduced	Percentage of all employees in salary range whose benefits may be reduced	Percentage of all employees
$29,000 to $29,999	26	96	.6
$30,000 to $30,999	40	98	1.0
Total	1,994	81	49

NUTTER, MCCLENNEN & FISH,
Boston, Mass., June 17, 1982.

MR. JOHN SALMON,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

DEAR SIR: As a law firm with an extensive practice in employee benefit plan matters generally and qualified plans in particular, we wish to express our vehement opposition to several provisions of the Bill. We recognize that the revenue needs currently faced by Congress are significant, but substantial changes in pension policy should not be based upon unstudied, isolated attempts at curing what are perceived by some as inequities or "loopholes". Such attempts might prove to be not only exceedingly costly to employers from the viewpoint of compliance, with little ultimate revenue or other benefit, but also might have wholly undesirable consequences for all—particularly if such attempts impact adversely on capital formation due to qualified plant terminations. In sum, we believe that pension policy must be approached on a coherent and comprehensive basis, with clearly defined objectives in mind. In this respect, we consider the Bill to be a clear step backward rather than forward.

Those provisions of the Bill which we consider most counterproductive to coherent and comprehensive pension policy include the following:

SOCIAL SECURITY INTEGRATION

The new rules set forth in the Bill for integrating defined benefit pension plans with social security embody a radically different concept of social security integration from that established initially by the Revenue Bill of 1942 and still in effect. These rules would shift focus in integrating such plans from the employee and his expected social security benefits to the employer and the actual contributions to the social security system such employer has made for the particular employee. From the section-by-section analysis issued for the Bill, the reason for this shift apparently is an attempt to cure a perceived inequity by preventing an employee's pension benefit from being reduced on account of social security benefits "attributable to taxes paid by prior employers or to the 'insurance' feature of social security under which benefit levels are set without regard to the sum of the actual taxes paid on behalf of the beneficiary." Presumably no added revenue could be expected from this change.

Whether or not such a change in the rules would ultimately prove to be the better approach, we are concerned that such a fundamental change with the vast costs to employers generated thereby has not received nearly enough study or even been thought through to some of its more obvious ramifications. For example, while purporting to cure one inequity, it would seem to create other, even more tangible, inequities from the employee-participant's point of view. Under the general rule, in an integrated defined benefit pension plan maintained by an employer with a social security offset based only on actual employer contributions to social security, two employees who are similar in all respects except that one has worked, say, ten years less for the employer than the other could have different pensions paid under the plan, with the larger pension being paid to the shorter-service employee because his social security offset under the plan would be smaller. This would be the case even though both employees receive the same amount from the social security system.

The significant costs to employers of complying with such new rules are obvious to anyone in the pension field and should not be underestimated. Virtually every integrated qualified plan would have to be reviewed, and actuarial studies made of the choices available under the new rules and the resulting changes in pension costs. These plans would then have to be amended (and presumably requalified with the Internal Revenue Service), with the resulting legal fees. Appropriate communications to the participants would be called for, with new Summary Plan Descriptions and other required reporting and disclosure materials being furnished. Since it is not at all clear that the new rules would be a simplification of the present complex social security integration rules, that explanation would be all the more difficult. Moreover, this task may be made more difficult by the fact that the new rules would be effective only for future participants, and thus plans would have to be amended to include dual integration standards. In addition, the record keeping to determine actual employer contributions to social security for each plan participant and the projection and conversion of these contributions into a permitted offset under the plan can be expected to add considerably to administrative costs.

Since the new rules can be expected to increase present pension costs of integrated plans, hardship for many employers who have funded their plans on the basis of current integration standards may result. Thus, many plan terminations can be anticipated, which in a sense would be a far greater inequity to employees, and certainly adverse to the goal of achieving increased capital formation through retirement savings, and would place an even greater burden on the social security system.

The Bill's safe harbor alternative to its general integration rules appears to be little more than a purely arbitrary solution to some of the administrative problems and costs those rules would generate. It does not have the justification in principle that either the old rules—focusing on the employee's social security benefits—or the new rules—focusing on the employer's actual contributions for such benefits—purport to have, and therefore would be subject to the criticism incurred by both approaches.

EXTENSION OF H.R. 10 PLAN RULES TO PERSONAL SERVICE CORPORATION PLANS

Also of serious concern to us is the apparent backward step the Bill would take in extending the H.R. 10 plan rules to the enumerated types of personal service corporations. Prior to 1962, self-employed individuals were entitled to none of the qualified plan benefits available to common-law employees. It was, however, generally recognized that there existed little justification for distinguishing an owner-manager who was incorporated and one who operated a similar business and realized similar profits, but who was a sole proprietor. The corporate operator was able to benefit from a tax-qualified pension plan, while the sole proprietor could not. The first major step in remedying this inequity was made by the Self-Employed Individuals Tax Retirement Act of 1962, permitting the establishment of H.R. 10 plans. Although full comparability of the self-employed individual with his counterpart corporate operator was not achieved by that Act, comparability was clearly the objective and only revenue loss considerations prevented its attainment. Since then, steady legislative progress has been made toward such full comparability, by P.L. 89-809, by the Employee Retirement Income Security Act of 1974 ("ERISA"), by the Tax Reduction Act of 1975, by the Tax Reform Act of 1976, and by the Economic Recovery Tax Act of 1981.

The Bill would continue progress in the limited respect of making fully comparable the dollar limit (but, significantly, not the 15 percent limit) on H.R. 10 plan contributions to those applicable to corporate plan contributions, and to this we have no objection. But, in addition, it would except certain selected personal service fields which, although incorporated, would be subjected to the more restrictive H.R. 10 plan limitations. In so doing, the Bill moves away from the full comparability concept that has always been acknowledged as equitable. It is difficult to comprehend any policy justification (other than short-term and short-sighted budget considerations) for selective targeting of the enumerated personal service corporation fields.

OVERALL DOLLAR LIMITS ON CONTRIBUTIONS AND BENEFITS

Admittedly, the overall dollar limitations of $25,000 and $75,000 set forth in 1974 under ERISA have escalated significantly since then because of the automatic cost-of-living adjustments also called for by ERISA, to a 1982 level of $45,475 and $136,425. While criticism of this rapid escalation may be justified, the remedy the Bill would effect seems extreme, since it would eliminate all future automatic cost-of-living inceases and would, in fact, roll back those limitations to $30,000 and $90,000. Would not a more sensible approach be to revise the formula for determining the automatic cost-of-living increases? Such extreme reactions as the Bill would take, even giving due regard to present revenue needs, make poor pension policy, and can be disruptive to plans designed, funded and invested on the basis of the higher dollar limits, and to plan participants who have relied on such amounts in their personal retirement planning.

We urge that any action on the provisions of the Bill, particularly those discussed above, be deferred until adequate study can be given to them and to all of the ramifications which enactment of the Bill would have both on those retiring over the next several decades and on their employers.

Respectfully submitted,

NUTTER, McCLENNEN & FISH.

SMITH KENNARD & OLSON,
Salt Lake City, Utah, June 17, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, Longworth Building, Washington, D.C.

DEAR MR. SALMON: In a telephone conversation yesterday with John Riordan, he indicated to me that the Committee was accepting written comments on H.R. 6410 if such comments were mailed prior to the close of business on Friday, June 18, 1982. The purpose of this letter is to set forth my feelings as to various aspects of the proposed legislation.

With respect to the proposed adjustments to the Section 415 limitations, I am extremely concerned about the effect this would have on retirement plans of all small businessmen, including professionals. Small, private sector plans are not in a position to adjust for cost-of-living increases which occur after an individual retires. The only insulation such plans have against cost-of-living increases is the contribution of more cash now. Large plans and government plans are better able to provide for cost-of-living adjustments because of the number of individuals contributing to the plan. In the case of government plans, the source of the retirement funds is not necessarily dependent upon the contributions of the participant and cost-of-living adjustments are routinely made. Particularly with the current state of the retirement system in this country, individuals ought to be encouraged to make contributions to private retirement plans and not discouraged.

In addition, by limiting contributions and benefits of qualified plans, funds which would otherwise be contributed to these plans will be funneled to less desirable investments or abusive tax shelters which will not benefit our personal savings balance and will encourage abuse of our voluntary compliance tax system.

By putting lids on contributions and benefits, small businesses will be forced to reduce the benefits provided for all employees because the dollar limitations will be low enough that a maximum percentage contribution need not be made for "key employees". If the contribution percentage for key employees is reduced from twenty-five percent to fifteen percent, the same reduction will apply to rank and file employees.

In addition, being able to work now for future retirement benefits is a strong incentive to productivity. By discouraging the amount that can be contributed to a retirement plan, the law is also discouraging productivity.

With respect to loans to plan participants, the description of the legislation prepared by the staff of the joint committee on taxation is very misleading. The explanation provides that the bill would "extend the rules to certain key employees" which are currently applicable to self-employed individuals. In truth, the rules would be extended to virtually all key employees. In small businesses, including professional corporations, the result is that those individuals who provide benefits to themselves and to the rank and file are being discouraged from establishing and participating in retirement plans.

If an individual is not permitted to borrow money from his retirement plan, he would be forced to borrow from a financial institution which would presumably charge an interest rate several points in excess of prime. This could very well be the same financial institution paying five to nine percent on his retirement fund. The plan and the participants ought not to be deprived of the benefit of the difference between the interest rates paid and the interest rates charged by the financial institution where the loan meets the requirements of the prohibited transaction exemption regarding participating loans.

In my discussion with Mr. Riordan, he mentioned a situation in which a corporation had made a contribution to a retirement plan, which was then borrowed out by the owner of the corporation, loaned to the corporation and recontributed to the plan. This cycle apparently occurred each year for four or five years. The disconcerting thing to me is that this example is cited as being typical of the kinds of abuse prevailing in the country. A large portion of my practice is involved with professional corporations and retirement plans and none of my clients have a situation like this, neither am I aware of any situation like this existing. Based on conversations with other local practitioners, I am firmly of the opinion that this type of abuse reflects a small minority of situations. The structure already exists to control this type of abuse through the prohibited transaction provisions of ERISA. The abuses are a problem caused by lack of enforcement, not a lack of legislation.

With respect to the possible use of participant loans to avoid the Section 415 limitations by paying excessive amounts of interest, this would not be a problem in a defined benefit plan because the earnings of the plan will affect future contributions. Neither would this be a problem in a defined contribution plan where the plan loan is treated as a general plan investment since all participants will share in their earnings, even the rank and file employees. There may be a problem in a defined contribution plan where the loan is treated as an investment of a particular individual's account, and it may be possible in that case to treat the excessive interest as unrelated business income which will be taxable to the trust.

This legislation appears to be working in cross purposes to the provisions of the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1978 which encourage the establishment of ESOPs for the benefit of the employees of the business since the percentage test used to determine "key employees" is so low that they would be covered by the bill.

The effect of this legislation is to further discourage the use of retirement plans by small businesses since the continual change in legislations and regulations makes maintenance of a retirement plan cost prohibitive. In spite of the favorable benefits provided by retirement plans, many small businesses, including some professionals, are not able to make sufficient contributions to justify the costs caused by annual reporting and nearly annual amendments.

I am further concerned that the effect of much of the proposed legislation would be to preclude key employees from obtaining certain benefits currently available to all employees, while preserving such benefits for rank and file. One reason an individual is a "key employee" is because his efforts are important if not essential to the production of income which all of the employees enjoy.

Very truly yours,

BRYCE E. OLSON.

OXY-DRY CORP.,
Elk Grove Village, Ill., June 15, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: As a small privately owned corporation we would like to state that we are in complete agreement with Mr. Philip W. K. Sweet's letter to you dated June 4.

We feel that the proposed Pension Equity Tax Act of 1982 is completely unfair to both employees and employers. We realize that the Federal Government faces huge tax problems and deficit problems, however, it is inequitable to penalize employees and employers by, in effect, posing an additional tax on their pension.

Sincerely,

JACK S. PETTERSEN,
President.

KENNETH M. ODMARK,
Vice President-Treasurer.

MCMURRAY, ANDERSON & MCINTOSH,
Salt Lake City, Utah, June 18, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Longworth Building, Washington, D.C.

DEAR MR. SALMON: In a telephone conversation two days ago with John Riordan, he indicated to me that the Committee was accepting written comments on H.R. 6410 if such comments were mailed prior to the close of business on Friday, June 18, 1982. The purpose of this letter is to set forth my feelings as to various aspects of the proposed legislation.

SECTION 415 LIMITATIONS

With respect to the proposed adjustments to the Section 415 limitations, I am extremely concerned about the effect such adjustments would have on the retirement plans of all small businessmen, including professionals, for the following reasons:

(1) Small, private sector plans are not in a position to adjust for cost-of-living increases which occur after an individual retires. The only insulation such plans have against cost-of-living increases in the future is the contribution of more cash now. Large plans and government plans are able to provide for cost-of-living adjustments because of the number of individuals contributing to the plan. In the case of government retirement benefits, the source of the retirement funds is not necessarily dependent upon the contributions of the participants. For this reason, cost-of-living adjustments tied to the Consumer Price Index (such as those available to members of Congress and Congressional staff members) are made automatically.

(2) By limiting contributions to and benefits from qualified plans, this legislation encourages the movement of funds which would otherwise be contributed to those plans to less desirable investments or abusive tax shelters which will decrease the personal savings balance and encourage abuse of our voluntary compliance tax system.

(3) By putting limits on contributions and benefits, small businesses will be forced to reduce the benefits provided for all employees because the dollar limitations will be so low that a maximum percentage contribution need not be made for "key employees". For example, only an individual making $180,000 per year could made an annual contribution of $45,000 under a defined contribution plan. If the dollar limitation under Section 415 is reduced to $30,000, that same individual need only contribute sixteen percent of compensation to achieve the same benefit. If the contribution percentage for the key employee is reduced from twenty-five percent to sixteen percent, the same reduction will apply to rank and file employees.

(4) Being able to work now for future retirement benefits is a strong incentive to productivity. By decreasing or limiting the retirement benefits available to key employees, the proposed legislation also discourages the productivity of those key employees. This decline in productivity of the key employees will effect the rank and file employees as well.

LOANS TO PLAN PARTICIPANTS

With respect to loans to plan participants, the description of the legislation prepared by the staff of the joint committee on taxation is very misleading. The explanation provides that the bill "extend the rules to certain key employees" which are currently applicable to self-employed individuals. In truth, the rules would be extended to virtually all key employees. In small businesses, including professional corporations, the result is that those individuals who provide benefits to themselves and to the rank and file are being discouraged from establishing and participating in retirement plans.

If an individual is not permitted to borrow money from his retirement plan, he would be forced to borrow from a financial institution which would presumably charge an interest rate several points in excess of prime. This could very well be the same financial institution paying five to nine percent on his retirement fund. The plan and the participants ought not to be deprived of the benefit of the difference between the interest rates paid and the interest rates charged by financial institutions where the loan meets the requirements of the prohibited transaction exemption regarding participant loans.

In my discussion with Mr. Riordon, he mentioned a situation in which a corporation had made a contribution to a retirement plan which was then borrowed out by the owner of the corporation, loaned to the corporation and recontributed to the plan. This cycle apparently occurred each year for four or five years. Other examples were mentioned, such as loans which are not repaid or loans to participants which are used to purchase assets for the employer. The disconcerting thing to me is that this example (and the other examples of abuse which were cited) are cited as thought they represent common practices. A large portion of my practice is involved with small businesses, professional corporations and retirement plans and none of my clients have situations like this, neither am I aware of any situation like this existing in this area (although I am sure some exist). Based on conversations with other local practitioners, I am firmly of the opinion that this type of abuse reflects a small minority of situations. Mr. Riordon even indicated that there was concern because even the potential for abuse exists. The structure already exists to control these types of abuse or potential abuse through the prohibited transaction provisions of ERISA. In addition, I believe the IRS has already adopted the position in

Revenue Rulings that these types of loans should be collapsed and the "substance" of the transaction governed. The abuses are a problem which should be controlled by enforcement of existing law and not the promulgation of more legislation.

With respect to the possible use of participant loans to avoid the Section 415 limitations by paying excessive amounts of interest, this would not be a problem in a defined benefit plan because the earnings of the plan will reduce future contributions. Neither would this be a problem in a defined contribution plan where the plan loan is treated as a general plan investment since all participants will share in their earnings, even the rank and file employees. There may be a problem in a defined contribution plan where the loan is treated as an investment of a particular individual's account. If the potential for abuse is viewed as great enough to warrant correction, it may be possible in this type of case to treat the excessive interest as unrelated business income which will be taxable to the trust. However, I still believe that the number of cases in which this type of abuse exists is very small.

GENERAL COMMENTS

This legislation appears to be working at cross purposes to the provisions of the Economic Recovery Tax Act of 1981 and the Revenue Act of 1978 which encourage the establishment of ESOPs (Employee Stock Ownership Plans) for the benefit of the employees of the business since the percentage test (5 percent) used to determine "key employees" is so low that they would be covered by the bill.

The effect of this legislation is to further discourage the use of retirement plans by small businesses since the continual changes in legislation and regulations increases the cost of maintaining a retirement plan. In spite of the favorable benefits provided by retirement plans, many small businesses, including some professionals, are not able to make sufficient contributions to justify the costs caused by annual reporting and nearly annual amendments.

I recently received a summary of the President's first annual report on the state of small businesses. According to that report, small businesses represent 99.8 percent of all business in the nation, produce 38 percent of the gross national product, employ 47 percent of the non-government labor force, contribute two out of three new jobs and produce twice as many innovations per employee as businesses with more than 500 employees. Before enacting legislation which so adversely affects this segment of our economy, I suggest that members of the Committee and Congress review the President's report as well as the most recent reports on terminations of retirement plans.

I am further concerned that the effect of much of the proposed legislation would be to preclude key employees from obtaining certain benefits currently availabe to all employees, while preserving such benefits for rank and file. One reason an individual is a "key employee" is because his efforts are important if not essential to the production of income which all of the employees enjoy.

I suppose that one of the truly ironic points raised by H.R. 6410 is that the bill was introduced by Congressman Rangel because he felt that professionals and other small businessmen ought to be subjected to the same sort of scrutiny on the "indirect benefits" that they receive through the tax system as those to which his constituents in the Bronx are subjected on the direct benefits they receive through the welfare programs of this Country. In this noble effort of Congressman Rangel and the House Ways and Means Committee to make sure that everyone is treated equally, I was pleased to note in last night's paper that the House Ways and Means Committee approved a bill raising the government's borrowing authority to $1.127 trillion after deleting an amendment that would have changed the $75.00 per day audit-proof deduction allowed members of Congress.

As long as legislation has been introduced allegedly attempting to achieve equity in the pension law, I suggest that if the bill is not killed, it be amended to provide for the same contribution limitations on individual retirement accounts for working and non-working spouses. A non-working spouse has the same retirement costs as a working spouse and the contribution limitations ought to be the same, particularly at a time when the social security system offers no security.

Very truly yours,

David O. Parkinson.

THE PERMANENTE MEDICAL GROUP INC.,
Oakland, Calif., June 22, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is a written statement for the printed record of the Committee's proceedings on H.R. 6410, the Pension Equity Tax Cut of 1982, and is submitted pursuant to the Committee's notice published on May 18, 1982. This comment is submitted on behalf of The Permanente Medical Group, Inc. ("Permanente") which we believe is the largest professional corporation in the United States.

I. SUMMARY

Permanente is a professional corporation that provides medical services in Northern California to over 1,750,000 members of Kaiser Foundation Health Plan ("Kaiser") and, with Kaiser, operates the Kaiser-Permanente Medical Care Program ("Kaiser-Permanente"). Permanente has over 8,000 employees including over 1,800 physican employees and over 5,000 union employees. Permanente provides substantial retirement benefits to all categories of its employees.

Permanente generally supports the Treasury's testimony on H.R. 6410 concerning professional corporations and limitations on benefits. The Treasury's testimony was well thought out, thorough, and presents good tax policy. Permanente believes, however, that some of the goals of H.R. 6410 and of the Treasury can be better achieved in a more direct manner, as described below.

A. Professional Corporations

Permanente supports the Treasury's position on retirement plans of corporations providing professional services and on "key employee" plans. The retirement plans of professional corporations should be treated no differently from the plans of any other corporations. Also, if special vesting, etc. rules are to be applied, they should only be applied if key employees (officers and over 5 percent shareholders) have a disproportionate share of the plan's benefits.

If the Committee does not adopt the Treasury's position and treats professional corporations differently from other corporations, H.R. 6410 should be amended to ensure that professional corporations without owner-employees and with a substantial ratio of common law employees to shareholder employees (*e.g.,* 3:1) are not subject to special plan rules.

B. Section 415 limitations

Generally, Permanente supports the Treasury's position on the changes in the section 415 limitation rules proposed by H.R. 6410. However, the goals of H.R. 6410 and of the Treasury can be better achieved by a direct limit on the amount of deductions allowed, and not by eliminating cost of living adjustments or reducing the 1.4 rule to a 1.0 rule.

If the Committee believes that the maximum tax deductions for qualified plans are too high, it should limit each employer's annual deductions for contributions to all of its qualified plans, singly or in combination, to, *e.g.,* 25 percent of covered compensation. Such a limit would allow the Committee to provide proper cost of living adjustments and a 1.4 rule—both necessary to provide adequate *real* retirement income—without also allowing "tax shelter" qualified plans.

C. Funding of pension benefits

To allow adequate current funding of defined benefit plans, H.R. 6410 should allow employers to fund pension plans by taking into account a reasonable cost of living adjustment to the section 415 dollar limits. This should be allowed, however, only if the employer's annual deductions for contributions to qualified plans do not exceed 25 percent of covered compensation.

II. THE PERMANENTE MEDICAL GROUP, INC.

A. Permanente is organized and operates as any large corporation

Permanente is a California professional corporation which provides medical services in Northern California to over 1,750,000 members of Kaiser Foundation Health Plan ("Kaiser"), a federally qualified HMO. Together, Kaiser and Permanente operate over a dozen medical facilities throughout Northern California, including facilities in Oakland, Sacramento, San Francisco, Hayward, Fremont, Walnut Creek, Richmond, Vallejo, and San Jose. Since 1948 Kaiser-Permanente has led the United States in providing high quality, low cost, innovative group health services.[1]

Permanente is organized and operated under the California professional corporation laws. It operates as other large corporations do, and has twenty-eight elected directors, as well as officers and staff. More unusually for a professional corporation, it has over 8,000 employees. Of this number, about 5,000 are union, about 1,200 are non-union non-physicians, and about 1,800 are physicians. Of the physician employees, 1,250 are shareholders. Each shareholder has an equal interest in the corporation and equal voting rights. Physician employees are not permitted to tailor the retirement benefits provided for them, as for other employees, by the corporation.

B. Permanente provides substantial retirement benefits to all categories of employees

Permanente provides substantial retirement benefits to all categories of its employees through tax qualified plans. Its union employees, of course, collectively bargain for their benefits. The other non-physician employees of Permanente have both a pension and a savings plan. The pension plan generally provides benefits of one and one-half percent per year of service multiplied by high five years' average compensation, with ten year "cliff" vesting. Under the savings plan, two percent of compensation is contributed by the employees and five percent is contributed by Permanente; the plan has seven year graded vesting. These plans are the same for all employees who work for the various parts of the Kaiser-Permanente. They are the same nationwide for all employees of the medical groups, Kaiser Foundation Health Plan, and Kaiser Foundation Hospitals. These plans are not integrated with Social Security.

Permanente also provides pension and savings plans for its physician employees which are generally comparable to the plans for non-union non-physician employees. For physicians, the pension plan benefit formula is two percent per year of service for the first 20 years and one percent for each year thereafter multiplied by high three years' average compensation; vesting is ten year "cliff". The savings plan is a salary reduction "cash or deferred" plan with an average deferral of about ten percent of salary; in accord with section 401(k), it has immediate vesting. These plans also are not integrated with Social Security.

C. The professional corporation provisions of H.R. 6410 would seriously restrict Permanente's existing retirement plans

H.R. 6410 generally would apply the restrictive Keogh rules for owner-employees to the retirement plans of all professional corporations. This would seriously restrict the retirement benefits available to physicians employed by Permanente, thereby preventing physicians from obtaining a moderate retirement income through qualified plans. This would occur even though Permanente acts, with respect to its retirement plans, as any other large corporation.

As a practical matter, the current maximum pension for Permanente physicians is 50 percent of final average pay. This is not an excessive pension and is similar to the maximum pension provided to non-physician non-union employees. Nevertheless, this pension generally would not be available to Permanente physicians if they also were to have a savings plan. In this case, Permanente's non-physician employees would have significantly better retirement benefits (as a percent of compensation) than the physicians.

In addition, the owner-employee rules would require immediate full vesting for all physicians. In this case, Permanente could not reserve its pension benefits for physicians who make a long term commitment to the Medical Care Program and would have to provide pension benefits to all physicians who participate in the plan, whether or not they stay with the medical Care Program. The consequence would be that the benefits for long term physicians would be reduced or the cost of pensions would rise, to the detriment of the cost containment goals of the Medical Care Program.

Applying the professional corporation rules of H.R. 6410 to Permanente, therefore, would disrupt a moderate retirement program, and do so without any apparent reason. Permanente does not present any of the problems which the professional corporation provisions of H.R. 6410 apparently address. It has a large number of employees, including over 5,000 union employees and it provides significant retirement benefits to all categories of its employees. Further, it does not permit professionals to tailor their retirement arrangements individually, to the potential detriment of other employees.

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[1] Nationwide, the Kaiser-Permanente Medical Care Program provides medical care to over 4,000,000 members in Northern California, Southern California, Oregon, Hawaii, Colorado, Texas, Ohio, and Washington, D.C. The physicians who provide these services in Southern California and in other States are not affiliated with Permanente but are members of other medical groups, some of which are incorporated and some not.

III. PERMANENTE GENERALLY SUPPORTS THE TREASURY'S POSITION ON H.R. 6410

Generally, Permanente supports the Treasury's position on the professional corporation and limitation on benefit provisions of H.R. 6410. Treasury's testimony was well thought out and thorough, and would on the whole promote good tax policy. Permanente believes, however, that some of the goals of H.R. 6410 and of the Treasury can be better achieved in a more direct manner, by amending the rules governing deductions to qualified plans.

A. Professional corporations

Permanente supports the Treasury's position on professional corporations and key employee plans set out in the testimony of Assistant Secretary John E. Chapoton before the Committee on June 10, 1982.

The nature of an organization's activities and the legal form of the organization are wholly irrelevant to the retirement plans it should be able to provide. In addition, if special rules are to be applied in order to encourage the provision of additional benefits for persons who do not control the organization, they should only be applied if "key" control persons have a disproportionate amount of plan benefits. Thus, only if "key employees" as defined in the Treasury's proposal (officers and more than five percent shareholders) have a disproportionate share of vested benefits should any special rules be applied. Also, as Treasury has testified, employees should not be treated as key employees solely because of their level of compensation; compensation bears no necessary relationship to control of an organization's decisions.

If, however, the Committee wishes to treat professional corporations differently from other corporations, the Committee should not apply any special rules to corporations such as Permanente that, in fact, resemble other large corporations with respect to retirement benefits. Like large corporations and unlike most professional corporations, Permanente is an organization with no employees who have a large percentage ownership and with a significant number of employees relative to the number of owners. The special Keogh rules, for example, should not be applied when (1) no owner-employee participates in the plan,[2] and (2) the ratio of common law employees (including any unionized employees) to shareholder-employees is, e.g., three-to-one (3:1) or greater.

B. Limitations on benefits and contributions

Generally, Permanente supports the Treasury's position on the amendments to section 415 proposed by H.R. 6410. However, the basic goals of H.R. 6410 should be addressed directly with amendments to the rules governing deductions for contributions to qualified plans.

1. The Deduction for Contributions to Qualified Plans Could be Limited to 25 Percent of Covered Compensation.—In introducing H.R. 6410, Mr. Rengel indicated concern with "tax-deductible contributions" to qualified plans and with the "indirect tax expenditure side of Government subsidies." However, H.R. 6410 deals with these issues only indirectly in the section 415 provisions on limitations of benefits.

If tax deductions are of concern, they should be addressed directly, and section 404 should be amended. For example, the existing provisions of section 404(a)(7) that limit deductible contributions to 25 percent of covered compensation for a combination of pension and profit sharing plans could be applied to contributions to all plans, singly or in combination. This would limit an employer's deductible contributions to 25 percent of covered compensation whether the employer had one or several plans of any type.

This rule would have several effects. It would substantially reduce the "tax shelter" aspect of qualified plans.[3] It also would encourage employers to establish qualified plans at an earlier date, because funding of benefits would have to take place over a longer period of time. This, in turn, would allow more employees to participate and would give employees longer periods of participation, increasing their vesting levels.

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[2] H.R. 6410 would use a 5 percent test instead of the 10 percent test of current law; Permanente has no objection to a 5 percent test.

[3] One study conducted for the President's Commission on Pension Policy shows that in plans where there were "tax deferral motives in plan design," annual contributions to defined benefit pension plans averaged about 40 percent of covered compensation.

In addition, this rule would tend to make plan funding less dependent on employer's earnings over a short period, reducing the vulnerability of plan funding to fluctuations in earnings. Additionally, we believe that many long term retirement programs already fit within this rule. (The rule also could provide adjustments for special, unforeseeable hardship cases, if desired.)

A 25 percent deduction limit also would eliminate the need for two other rules proposed by H.R. 6410 that conflict with sound retirement policy—the elimination of cost of living adjustments and the "1.0" rule. These two proposals limit benefits and thereby indirectly limit deductions for contributions to qualified plans. With a 25 percent deduction limit, they are not necessary.

2. Reasonable Cost of Living Adjustments Are Needed.—We live in seriously inflationary times. While today the rate of inflation has been reduced, there is no way to know if this will continue. In addition, retired people feel inflation, and fear it, intensely. Therefore, people must be allowed to provide for adequate real retirement income. This requires allowing cost of living adjustments to the dollar limits of section 415. Once the appropriate dollar limits have been established, there is no reason to fail to index them, because those limits will present the Congress' judgment on the proper real level of benefits.

Adjustments to the dollar limits should not be left to ad hoc Congressional action. As with Keogh plans, Congressional adjustments will occur infrequently. This makes it extremely difficult to rationally plan for and fund retirement benefits.

If the existing index in section 415(d) is correct, in the past eight years the real value of one dollar has dropped to 56 cents. At the same rate of inflation for the next eight years, a $90,000 pension limit will be a real $50,000 limit. With a 1.0 rule and an employee cash and deferred savings plan of, e.g., 10 percent per year, this becomes a $30,000 real limit. This limitation would apply to employees now 57 years old, if retirement age is 65. And that $30,000 will shrink if there is more inflation during retirement. The result is not fair retirement income policy.

Permanente recognizes that there are serious questions about the applicability of the existing section 415(d) index for adjusting the dollar limits. However, whatever measure is used to determine the proper measure of inflation, the same general effect described above will occur.

To allow fair, real retirement benefits, therefore, the 415 dollar limits must have a cost of living adjustment. Additionally, whatever index is used, it should be chosen carefully to reflect retirement needs. We would appreciate an oppportunity to work with the Committee's staff to develop an appropriate index.[4]

3. The 1.4 Rule Should Be Retained.—The combined reduction of the dollar limits plus a reduction of the 1.4 rule to a 1.0 rule will disrupt retirement planning of Permanente physicians by forcing an unfortunate choice between a savings plan (with money at the risk of market fluctuations) or a pension plan.

In addition, a 1.0 rule has an upside down effect. In the case of Permanente, a young, short-term physician who has not committed his professional life to the Kaiser-Permanente Medical Care Program will be able to accrue a full pension benefit and set aside the full amount available under the cash or deferred plan. However, the longer term physician who has committed his professional life to the Medical Care Program could not have a pension of 50% of his final average compensation and also set aside 10 percent per year in a savings plan. Therefore, the physicians on whom the Medical Care Program depends in the long run will not be able to provide a reasonable retirement income for themselves, but the short-term physician employees will. Retirement income policy should not promote this result.

C. Funding

Permanente hopes to fund its pension benefits currently to endure that physicians currently pay for their own retirement benefits. Without this type of funding, in the future younger physicians would have to pay for the pensions of retired physicians. In an organization such as Permanente, this situation can be highly divisive. (In fact, we understand that this type of problem was an important factor in the recent split-up of a large West Coast law firm.) Such a problem would be extremely serious for the long-term future of the Kaiser-Permanente Medical Care Program.

H.R. 6410 should be amended to allow current funding within established rules that prevent abuse. Accordingly employers should be able to fund for defined benefit pension plan benefits using the (new) dollar limits of section 415, adjusted for the cost of living index ultimately adopted by the Committee, but *only if* the employer's annual deductions do nodt exceed 25 percent of covered compensation.

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[4] For example, an appropriate index may be the only ultimately used for Social Security benefits. Or, it may be a wage-based index that takes account of wage inflation as well as productivity increases.

Respectfully submitted,

W. WILLIAM PETRICK.

PHILADELPHIA SUBURBAN CORP.,
Bryn Mawr, Pa., June 17, 1982.

Congressman RICHARD T. SCHULZE,
Rayburn House Office Building,
Washington, D.C.

DEAR DICK: The purpose of this letter is to express our concern over H.R. 6410, The Pension Equity Tax Act and urge you to oppose this bill in its entirety.

Introduced by Representative Charles Rangle (D-NY), the bill would amend the Internal Revenue Code to "provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employes in tax-subsidized pension and fringe benefit plans and to reduce the excessively high tax limits on tax-free accumulation under corporate pension plans." We shall not argue the merits of the bill's objectives but shall, instead, concentrate on a few of the likely adverse consequences of its passage.

The Rangle bill proposes $90,000 per year limit on pensions from qualified defined benefit plans. This limit is not adjusted for future inflation. Consider for a moment that if inflation continues to average 9 percent and if a company grants annual merit and promotional increases of only 4 percent, a 46 year-old making $20,000 will be affected by the limit. Worse yet, a 40 year-old would be affected if his current pay is at least $10,000. And since H.R. 6410 will reduce the limit for retirement before age 65, these illustrations could get even worse.

The bill further proposes a $30,000 limit (not exceeding 25 percent of pay) on additions to qualified defined contribution plans. This limit is also frozen and not to be adjusted for inflation in the future. An employee covered only by a profit sharing plan can earn as much as $120,000 before the effects of this provision are felt. However, as shown above, in just a few years, this limit will be applicable for more and more employees as a result of inflation.

These limits, plus the subtle change in the combined plan limit from 140 percent to 100 percent of the single plan limit would have a devastating effect on the retirement security of younger employees.

As Social Security faces cutbacks in benefit levels, it is ironic that such a bill would be introduced to dissuade employers from seriously considering options to fill the void in employees' anticipated post-retirement income.

Instead, the Rangle bill will foster the use of non-qualified "excess" loans. Since non-qualified plans can be discriminatory and are generally not funded, such a shift of pension liability from qualified to non-qualified status hardly seems in the interest of the employees.

As it applies to fringe benefits, H.R. 6410 raises even more questions. For example, as it is written, the bill suggests that disability benefits programs—both short term and long term—could not provide benefits that are related to pay.

We also envision many of the other features of this bill as having such limited net value as to be far outweighed by the administrative inconvenience.

In short, we believe the Rangle bill has been conceived in haste with little attention to its long range implications. Passage of this bill would be a mistake.

Sincerely yours,

JOHN W. BOYER, Jr.

STATEMENT OF PHILLIPS PETROLEUM CO.

Phillips Petroleum Company is an integrated energy company engaged in the exploration, production and marketing of petroleum and related products on a worldwide basis. Founded in 1917, Phillips maintains its headquarters in Bartlesville, Oklahoma and currently employs over 34,000 people.

In addition to numerous separate qualified employee benefit plans maintained by subsidiary companies, Phillips maintains a defined benefit pension plan covering over 22,000 employees, as well as a profit-sharing plan and a tax credit employee stock ownership plan. The company's goal in maintaining these plans is to enable our retiring employees, by the combination of Phillips-sponsored plans, government programs and personal savings, to maintain a post-retirement standard of living which bears a reasonable relationship to that of their pre-retirement years. We believe that our attainment of this goal is in the best interests of our employees, our company and the economy of our country. We also believe that the enactment of H.R. 6410 would be seriously detrimental to those interests.

Ostensibly intended as a revenue-raising measure, even such limited analysis as time has permitted since the introduction of this bill indicates that it may, in fact, result in higher costs and therefore larger tax deductions to corporations which sponsor qualified plans. In addition, by prompting a trend away from qualified plans and toward nonqualified plans, enactment of this bill could deprive growing numbers of employees of the protections which ERISA was so carefully formulated to provide.

I. SECTION 415 LIMITATIONS

One area of particular concern to Phillips is Section 2 of the bill which would drastically reduce the Section 415 limits on contributions and benefits which could be provided to employees from qualified plans, and would remove the annual cost of living adjustment to these limits.

The present limitations of Section 415 are the product of long and careful consideration before their inclusion in ERISA, and should not be drastically altered by the hasty enactment of a measure whose effects may not have been fully considered.

Particularly unjustified is the bill's provision that would reduce the overall limit from 1.4 to 1.0, since it could require a reduction of total benefits to even low paid employees. Furthermore, such a provision ignores the fact that defined benefit (e.g. pension) plans and defined contribution (e.g. profit-sharing) plans are designed to and do meet two different needs of employees—long-term retirement income needs and mid-life needs (education, home purchase, etc.) respectively. Reducing the overall limits to 1.0 forces employees to forego satisfaction of one need or the other, despite the fact that their employer established and funded plans to assist with both. The current overall limit in no way "disregards" the separate limits, since 140 percent is already a substantial reduction from the otherwise combined limit of 200 percent.

In the long term, the most dangerous provision in this bill may be the elimination of the cost of living adjustment, *i.e.*, "COLA" to the Section 415 limits, because if could destroy, in a surprisingly short time, the ability of private pensions to provide realistic retirement income levels to employees.

While a pension of $90,000 per year may sound adequate, or even liberal, today, without some kind of cost-of-living adjustment, such a fixed amount will consistently erode in real spending power, even with only moderate levels of future inflation, until it totally fails to keep faith with an employee's reliance on his retirement benefits replacing a fair portion of his pre-retirement earnings.

Moreover, there is no justification for removal of these cost-of-living adjustments in the private system as there is in the Social Security program. COLA's have turned out to be a serious mistake under Social Security because benefit payments from that pay-as-you-go program have outstripped its revenues. The same problem does not exist in the private system, which is required to fund at sufficient levels to meet its benefit obligations.

We believe it is not an overstatement to say that these changes would impair the fundamental viability of the private pension system. It has become clear that the Social Security system cannot continue to bear the burden of being the major source of retirement income. The availability of IRA's to all employees has simply not been in effect long enough for their personal savings to reach an adequate level. Therefore, it is imperative that the private pension system be allowed to maintain its ability to offer employees a dependable source of real future spending power for their retirement. This will not be possible if H.R. 6410 is enacted.

Two other important points concerning the Section 415 provisions of this bill seem to have been overlooked by Rep. Rangel's explanation. First, the Section 415 limits not only reduce the employer's deduction under Section 404 for plan contributions, the penalty for exceeding the limits, even by inadvertent error and even as to a single plan participant, is disqualification of one or all of the employer's qualified plans.

The calculations necessary to monitor Section 415 compliance are exceedingly complex and are administratively costly and burdensome. At present levels, these burdens are manageable since relatively few employees are potentially affected. However, the immediate impact of reducing the dollar limitations and of reducing the overall limit to 1.0 is that the calculations will have to be done every year on a far greater number of employees. Furthermore, these numbers will grow each year as an unadjusted dollar limit forces more and more employees toward the limits. We believe this will geometrically increase the risk of inadvertent error which could jeopardize the qualified status of our plans, and result in extreme and unjustified harship to our employees.

The second point is that the Section 415 provisions of this bill may not actually result in a lower total tax deduction to the employer for providing retirement benefits to employees. It is quite common for companies to maintain a nonqualified plan to make up the difference between an employee's promised accrued benefit and the amount of that benefit which can be paid from a qualified plan. If this bill is passed, such "excess plans" will become more common and, as future accrued benefits increase with years of service and compensaiton, an even greater proportion of an employee's retirement benefits will be paid from the nonqualified plan. Payments from such plans are generally deductible by an employer under Section 162 in the year paid to the extent that they are ordinary and necessary business expenses. Thus, any revenue savings from reducing the Section 404 deduction may be substantially or completely offset by the increased deductions property allowed by Section 162. (We note also that other provisions of the bill, such as doubling the allowable deduction for Keogh plan contributions, would have a similar result of *increasing* the "indirect tax expenditure side of Government subsidies" to which Rep. Rangel referred.)

Aside from negating any revenue savings, we believe the far more ominious effect of the bill's Section 415 provisions could be that, by forcing a trend away from qualified plans and toward nonqualified "excess" plans, it would seriously undermine the protections of the ERISA affords to employees, in terms of its requirements on funding, eligibility, vesting and nondiscrimination, none of which apply to nonqualified plans.

II. INTEGRATION WITH SOCIAL SECURITY

The other major area of concern to Phillips is the provision of H.R. 6410 concerning integration of an employer's plans with Social Security. Like those of many companies, our parent company's defined benefit pension plan includes a Social Security offset in one of its althernative benefit formulas (1.5 percent per year of credited service, up to a maximum of 50 percent of the primary insurance amount).

The provisions of this bill could dramatically reduce the maximum allowable offset. For companies who could afford to retain the same benefit formula with a much lower offset, the result could be a staggering increase in the required funding level of the plan (with a corresponding increase in tax deductions). It may be more likely that employers would have to amend their plans to provide for a different benefit formula for participants affected by this provision. Thus, this portion of the bill may simply result in lower benefits to employees.

It is especially inapproprite to tamper with the existing balance between the private pension system and the Social Security system at this time. We believe that any changes in this area should at least be postponed until the National commission on Social Security Reform issues its recommendations and they are carefully analyzed.

Taken as a whole, H.R. 6410 would make sweeping changes in the laws and policies governing private pensions of such a magnitude that it should not be passed without careful study and analysis of its long-term effects.

We urge Congress to allow sufficient time for such analysis and in doing so, to avail itself of the experience and expertise of the private sector in considering whether this bill would, in fact, have a desirable effect.

STATEMENT OF MICHAEL E. PIETZSCH, ESQ., MCCABE, POLESE, & PIETZSCH

On behalf of my clients, who consist primarily of small and medium-size businesses and professional corporations, I wish to comment on H.R. 6410, the so called "Pension Equity Tax Act of 1982", which is presently under consideration by the Committee.

1. Limitations of Contributions and Benefits.—The bill would severely reduce overall limitations on contributions and benefits presently available under tax-qualified pension and profit sharing plans. Specifically, maximum dollar limitations on allocations to so-called defined contribution plans (profit sharing and money purchase pension plans) would be reduced from $45,475 to $30,000. Maximum dollar limitations on annual benefits payable under so called defined benefit plans would be reduced from $136,425 to $90,000.

Equally important, these dollar limitations would no longer be subject to automatic cost-of-living increases.

Third, the aggregate limit applied to participants covered by both a defined contribution and a defined benefit plan maintained by the same employer would be reduced from 140 percent to 100 percent of the otherwise applicable separate limits.

Finally, severe limitations would be imposed upon the annual benefit limitations under a defined benefit plan in cases where retirement benefits begin prior to age 65.

Comment: Generally, it can be assumed that contributions and benefits to existing private pension plans will, for the most part, have to be reduced severely to comply with the new proposed limitations. It is simply not true that a significant number of existing private pension plans do not already fund up to the allowable limits. Ultimately, the effect of the proposed bill would be not only to reduce contributions and benefits made on behalf of or made available to shareholders and other highly paid employees, but would also drastically reduce the contributions and benefits payable to millions of rank and file American workers. The severe reduction in contribution and benefit limitations could also be expected, in a large number of instances, to convince an employer that the relative benefits of maintaining such a plan are no longer commensurate with the costs associated with plan administration, legal and accounting services, investment expense, and, PBGC premiums and other direct costs associated with compliance under federal reporting and disclosure rules.

In addition, the elimination of future increases in contribution and benefit limits with cost-of-living increases would also mean that private pension plans would fall farther and farther behind in their ability to fund meaningful pensions for American workers. This is a particularly sad commentary in view of the presumed new policy of Congress to encourage greater reliance on private pension plans instead of leaving citizens almost totally dependant on Social Security for support after retirement.

It also seems wholly inappropriate to seek to reduce contribution and benefit limitations as a means of increasing federal tax revenues. First, it must be realized that contributions to private pension plans are entirely voluntary on the part of the contributing employer and/or its employees. Second, although it is true that contributions made within allowable limits may be deducted by an Employer for federal income tax purposes, amounts contributed to qualified plans are not exempt from federal income tax; rather, federal income tax on such amounts is merely deferred. In addition, tax revenues may be ultimately enhanced due to the fact that distributions of benefits from qualified plans are subject to tax as ordinary income, (i.e., such benefits do not qualify for capital gains treatment, even if all or a substantial portion of the earnings or appreciation on Employer contributions is attributable to sale of appreciated capital assets.)

2. Loans to Plan Participants.—Under current law, qualified pension and profit sharing plans are generally permitted to make loans to plan participants, if such loans bear reasonable rate of interest, are adequately secured, provide a reasonable payment schedule, and are made available on a basis which does not discriminate in favor of shareholders and other highly compensated employees.

The bill would prohibit altogether the making of a loan to a participant who is a "key employee". This prohibition against loans to owners, employees and highly paid employees extends even to so-called "cash and deferred plans" under which contributions (in the form of deferrals of otherwise current income) are made on a voluntary basis by Employees.

Comment: The impact of the proposed prohibition of loans to plan participants would be to eliminate a useful method of financing home purchases and other needs arising from unforeseen financial hardship. Such a prohibition would result in considerable loss of flexibility and utility under private pension plans. This loss of flexibility is particularly unfair where voluntary employee contributions themselves are concerned.

3. Integration with Social Security.—The bill introduced to your committee would revise current Social Security integration rules to eliminate the ability of an employer to provide benefits, from retirement plans and Social Security, for employees at all salary levels, which bear a uniform relationship to their pay.

Comment: The proposed change in Social Security integration rules would eliminate a rational means whereby aggregate retirement benefits can be adjusted to fairly structure total benefits in uniform relation to pay. The legislation would have the effect of aggravating existing discrimination against certain employees under the Social Security system. The impact of these provisions would be to greatly increase the cost of providing reasonable levels of benefits under private pension plans and, therefore, would have the effect of reducing current benefit levels or causing employers to eliminate plans altogether.

4. Reduction in Estate Tax Exclusion for Retirement Savings.—The new bill would impose an aggregate $500,000 limit on the estate tax exclusion otherwise applicable to amounts payable under qualified retirement plans or individual retirement accounts.

Comment: For most owners of small or medium-sized businesses, and virtually all professionals, qualified plan benefits constitute virtually all of the individual's estate. Historically, Congress has found strong public policy reasons for allowing exclusions of qualified plan distributions from federal estate tax purposes so as to encourage the accumulation of both retirement savings and death benefits for surviving spouses and other beneficiaries. The imposition of a limitation on the estate tax exclusion for retirement savings would have the effect of making private pensions less attractive and, at the same time, would directly harm beneficiaries of qualified plan participants.

5. Rules Concerning Professional Service Corporations.—Perhaps the most galling features of the new bill are the provisions which would subject retirement plans of professional service corporations (in fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics, and consulting) to special restrictions, including immediate vesting, prohibition of individual trusteeship of the plan, restrictions on payment of benefits to shareholder employees before age 59½, and a requirement to payment to shareholder employees commence by age 70½ regardless of retirement.

Comments: The proposed changes embodied in the new bill are, on their face, blatantly discriminatory in their effect. It is inconceivable that any rational public policy can be furthered by making it more difficult for persons employed in professional service careers, and their employees to provide for their retirements. If anything, it is generally more difficult to accumulate retirement savings in a professional service organization than in a business which involves the application and accumulation of considerable capital. To provide for retirement, professionals and employees in service organizations generally must fund their pensions from current earnings. The proposed legislation would make it virtually impossible for professionals or other service organization employees to provide adequately for retirement.

Not only are the new proposed changes discriminatory, but because of the restrictions on plan flexibility and benefits, the new rules are certain to result in the termination of plans affecting vast numbers of employees.

6. In General.—One reason given for the proposed changes incorporated in H.R. 6410 is the need for "equity" in the tax and pension system. However, the ultimate result of this legislation, if adopted, would simply be to compel employers to terminate private pension plans. A rational employer, if required to discriminate against shareholders and other key employees, would be likely to simply eliminate pension plans altogether. A rational, highly paid individual, will not necessarily pay any greater federal income tax; instead there will be a shift away from private pension programs, which impact positively on capital formation, savings, and other workers' benefits and into less productive and less socially-useful forms of "tax shelters". At the very least, a rational owner of a small business or a rational professional would be inclined to take more current compensation in lieu of contributing to a private pension program on behalf of his employees. It is true, in some cases, that revenues collected by the Treasury might be enhanced, but at the expense of rank and file employees' pension plan contributions and benefits.

It is inconceivable that the elimination of incentives for retirement savings, and the creation of greater incentives to increase owners' salaries and bonuses, could be the intended result of this legislation.

In an era when capital formation is vitally necessary to this nation's economy, and where greater rather than reduced incentives to create private pensions and to supplement Social Security are required, the passage of legislation such as H.R. 6410 would not only be counter-productive but irrational.

Further, the elimination of private pension programs, which would almost certainly result from the adoption of this legislation, is certain to impact more heavily on those rank and file workers who most desperately need assistance in accumulating retirement savings. Ironically it may well be that the middle class workers, historically the backbone of our nation's economy, is the most likely to suffer from a reduction in private pension programs.

Anticipated income replacement provided by Social Security is woefully inadequate for retired Americans other than those in the lowest income brackets. At the same time, middle income workers generally have no capacity to accumulate meaningful retirement savings. The primary source of retirement benefits for a very substantial number of middle income Americans is the private pension system. The threat on this system posed by H.R. 6410 should be of deep and abiding concern to all members of the Committee. How can any Representative or Senator explain to his constituency that private pension benefits have been eliminated or severely reduced—at a time when it is proposed that Social Security benefits be capped or, at least, that future increases in Social Security benefits be reduced—in the name of increasing current revenues?

7. Proposed Alternatives.—If, in fact, it is the intent of the Congress to eliminate those elements of private pension programs which are truly "abusive", I respectfully suggest that you consider making the following changes only: (a) Require that the Trustee of the Trust forming a part of a private pension or profit sharing plan be a bank or other qualifying financial institution; and (b) limit, by statute, the ability of employers to project increased limitations of benefits (under Section 415 of the Internal Revenue Code) for funding purposes.

If, as some commentators have suggested, Congress is truly concerned about eliminating inequities between unincorporated and incorporated professionals, "parity" could be achieved by increasing current limitations on contributions and benefits, and eliminating other discriminatory restrictions, presently imposed on plans for self-employed (Keough plans); there is no reason to believe that in order to achieve parity, self employed plan rules cannot be liberalized rather than corporate pension plans penalized.

Of course, any changes in existing pension rules should be the result of a careful reasoned analysis and a thorough discussion of the merits of the changes—not a hasty and misguided effort calculated to produce a "quick fix".

8. Summary.—I urge you strongly to consider fully the ramifications of the ill-conceived and discriminatory legislation before the Committee. A hasty consideration of this legislation could have a terrible and long lasting effect on the quality of life for this nation's workers, and the ability of the nation's productive enterprises to have access to savings while ultimately achieving very little in terms of overall revenue enhancement.

The title of this bill, the "Pension Equity Tax Act" is a cruel and gross misnomer. By adopting such legislation, you would be imposing a horrible penalty upon the private pension system, leading ultimately to further economic suffering and unfairness for all American workers.

POOL CO.,
June 18, 1982.

Hon. DAN ROSTENKOWSKI,
Rayburn House Office Building,
Washington, D.C. 20515

DEAR CONGRESSMAN ROSTENKOWSKI: The purpose of this letter is to enter our formal statement into public record regarding proposed House bill H.R. 6410.

Pool Company is an oil field services company providing well servicing and contract drilling services worldwide to the petroleum industry both onshore and offshore.

We want to focus our comments on a broader implications of the proposed legislation.

1. We are concerned that any pension legislation of this magnitude could hinder, rather that encourage, the growth of the private pension system.

2. We question whether the government can realize any significant amount of indirect revenues by making these changes.

3. We question whether any changes should be made in social security integration rules before larger issues concerning the social security system have been addressed.

4. We are concerned that attempts to limit loan privileges from plans utilizing Section 401(k) of the Code will defeat a portion of Congress' original intention of establishing such plans (provided for as recently as the Revenue Act of 1978).

We urge Congress to assess the need for the proposed legislation more closely. If such legislation is indeed needed, we ask for more time to study and discuss the implications of the proposed changes. In any event, we feel strongly that the types of changes in this bill should not be the result of a hasty search for further government revenues.

Sincerely,

WILLIAM B. ROBERTSON,
Director, Corporate Personnel.

David N. Price Inc.,
Fresno, Calif., June 14, 1982.

John J. Salmon,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

Gentlemen: As an administrator and consultant in the pension business representing clients, and small businessmen who have pension and profit sharing plans, I express my opposition to this legislation, (H.R. 6410). For several reasons, I do not believe it beneficial to the employees, to society or the economy for the Pension Equity Tax Act to become law.

We keep close contact with our clients: They are seen on a yearly basis. Therefore, I feel I am tuned in to the needs of the common-law employee. Passage of the bill will reduce benefits of lower-paid employees by reducing the benefit levels and contribution levels for high-paid employees. Just as the passage of Internal Revenue Code 414(M), affiliated service groups, has caused decreased benefits for lower-paid employees when that was not the intent.

These employees, who make up the greater part of the tax-paying society are living in an era of inflation, longevity and rising health care costs. To undermine the private funding of these needs is contrary to the best interests of society.

They are living in a nation that is becoming less and less economically self-sufficient with a diminished ability to rely on a nearly-bankrupt public system. The private pension investments are creating financial independence for a large block of the private sector which would otherwise be on public assistance programs. And pension funds are a major source of investment capital. Any lowering of funds of private sector plans would be detrimental to the economy.

Even with the economic conditions that exists today, it would be agreeable with the undersigned to do away with the cost of living adjustments for private pension plans, provided that the same bill did away with the cost of living adjustment for the public pension plans, for social security, veteran benefits, armed forces retirees, U.S. Congressmen, U.S. Presidents, and all other public employees. The individuals who are paying the taxes for the public employees cost of living adjustments are the ones who can't have them. Why should there be a double standard?

There has not been sufficient lapsed time since the enactment for the 1974 changes, namely ERISA, to make any alterations to that very historical legislation. To require employers to again restructure their retirement systems is a costly, unfair request.

The private sector is attempting to work in the framework and intent of that law and from my information, they are doing an excellent job. To change the benefit systems would not only be a detriment to the financial security of a large number of lower-paid employees, but it would discourage employers from establishing or maintaining private sector plans which would, in the long run, weaken the social and economic systems in our nation.

Sincerely,

David N. Price.

PAS—Professional Administration Services, Inc.,
Syracuse, N.Y., June 1, 1982.

John Salmon,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: I am unable to testify on or after June 8, 1982, with regard to HR 6410, sponsored by Representative Charles Rangel (Democrat, New York).

However, I would like to go on record as emphatically opposing this sort of Legislation. In a similar vein, I am opposed to the position enunciated by Senate Finance Committee Chairman, Robert Dole.

At a time when the Social Security Retirement System is (or at least is perceived to be) in deep trouble, and when its benefits can only be limited (absent unreasonable additional taxation), it seems to me that the Private Pension Sector is the only place to turn for future Retirement Benefits. The legislation outlined above serves to reduce the attraction of those Plans, and, therefore, in my opinion, is counterproductive.

I also feel that Mr. Rangel completely misunderstands the impact of large Pension Plan Contributions on the overall economy. While it is true that these dollars are contributed in a tax-favored manner by Corporations, certainly it must also be understood that they are invested in our economy in a variety of ways—not the least of which, as a result of new legislation, will be in the Real Estate areas. And, obviously, these dollars also find their way into all manner and means of investments, including direct obligations of the Federal Government. So, I fail to understand what advantage will be gained if we curtail the size of the Plans which can be created.

I would very much appreciate this correspondence being made a part of the Committee's records.

Sincerely,

WILLIAM P. BYRNE.

IVINS, PHILLIPS & BARKER,
Washington, D.C., June 7, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I am writing to express the views of Public Service Electric and Gas Company with respect to H.R. 6410, "The Pension Equity Act of 1982", introduced by Representative Charles Rangel on May 19, 1982. Public Service requested an opportunity to be heard at the June 8, 1982 hearings but was denied its request to appear.

Public Service Electric and Gas Company is an operating public utility company, providing electric and gas service in areas of New Jersey in which about three-fourths of the State's population reside. The Company is the nation's third largest combination electric and gas company in revenues from sales to ultimate consumers and fourth largest in investment in utility plant.

Public Service maintains a qualified defined benefit pension plan which is integrated with Social Security, a qualified thrift-profit sharing plan, and a qualified Tax Reduction Act employee stock ownership plan (TRASOP). Essentially all of the company's approximately 13,000 employees (some of whom are represented by collective bargaining) participate in the pension plan and the TRASOP. Approximately 4,800 employees participate in the company's thrift plan. In addition, the company has several statutory fringe benefit plans.

One of the stated purposes of the Bill is to provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans. A second major objective of the legislation is to reduce the excessively high tax limits on tax-free accumulations under corporate pension plans.

Public Service is a strong supporter of the private pension system. It believes that the present tax system provides adequate tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax subsidized pension and statutory fringe benefit plans. It also believes that the tax limits on tax-free accumulations under corporate plans are not excessive but are reasonable. Public Service believes that the enactment of this Bill may well have a counterproductive effect on the private pension system as many employers may be forced to cut back benefits for rank and file employees rather than increasing benefits.

Public Service has several general and specific objections to and comments with respect to the Bill:

1. Fast Track.—H.R. 6410 is a complex Bill which requires careful, deliberate consideration because of its potential significant impact on the private pension system. The Bill, however, seems to be on a fast track. Hearings on the Bill are being held only days after its contents became generally known. Certainly few employers (Public Service is not one) have had the time to analyze the full potential impact the Bill will have on their employee benefit plans. ERISA took several years to develop. If the Congress tampers with the balanced provisions enacted as part of ERISA and which have been in operation for many years without careful analysis it could be doing a tremendous disservice to the future of the private pension system.

2. Contribution and Benefit Limits (Section 2 of the Bill).—Section 2 of the Bill would (a) reduce the limit on the annual defined benefit which may be provided by a qualified defined benefit plan from $136,425 in 1982 to $90,000 and the limit on the annual defined contribution which may be made on behalf of a participant from $45,475 in 1982 to $30,000; (b) repeal the cost-of-living adjustment to those limits; (c) reduce the maximum combined limits where individuals are covered by both a defined benefit plan and a defined contribution plan from 140 percent to 100 percent and change the method of computing such percent; (d) require actuarial reduction for benefits commencing before age 65; and (e) require inclusion of the value of certain post-retirement medical benefits in determining the benefit limits. Public Service opposes these provisions of the Bill.

The present limits on contributions and benefits are not excessive. They were set by the Congress after lengthy deliberation that preceded the enactment of ERISA. The limits established in 1974 were designed not to be too restrictive as that would encourage executives to reduce retirement benefits down the line. As Senator Bentsen commented on the Senate floor when ERISA was being developed, "We might thus have a rippling effect, and hurt the very people we do not want to hurt, the employees." Cong. Rec.—Senate, Sept. 19, 1973, Legislative History of the Employee Retirement Income Security Act of 1974, 1973 (1976) (hereafter "Legislative History"). Reducing the limits in the radical way proposed by the Bill will have an adverse impact on the "financial drag" effect. In corporate plans, if large contributions are made for executives, then the antidiscrimination provisions of present law require that proportionate contributions be made on behalf of rank and file employees. This "financial drag" effect tends to impose practical restrictions on the size of contributions made for the highest level of employees and it also means that if large contributions are made for this group, then lower level employees will also benefit.

Repeal of the cost-of-living adjustment would perhaps be one of the most harmful aspects of the Bill. The feature was included in ERISA "because of the vital importance of maintaining the real value of retirement benefits" (Legislative History, 2625) and in order "to prevent the erosion of the value of an employee's pension due to inflation". Legislative History, 2707. It is difficult to understand the justification for the removal of the cost-of-living adjustment (except for the revenue impact, that is). Social Security, federal employee and military retirement benefits are indexed to changes in prices. The President's Commission on Pension Policy, in fact, recommended that private pension plans provide some form of inflation protection for retirees. A move to repeal the COLA provisions in Code section 415 would therefore be a step backward.

Public Service will not increase or reduce its contribution or benefit levels under its qualified plans if these changes in the limits on contributions and benefits are enacted except to the extent required. What will happen is that some of the benefits under its plans will be unfunded. Instead of increasing the funding level of pension plans, as ERISA was designed to do, this aspect of the Bill will decrease the funding of pension benefits. Decreased pension plan funding, not decreased benefits or contributions will be the practical effect of this proposal since there is no limit on compensation or benefits which may be paid to employees. The real and psychological impact of this decreased level of funding is impossible to predict with precision but it hardly can be said to be beneficial to Public Service's employees or to any employer's employees.

However, Public Service will have to reexamine its plans to expand its thrift plan to include a qualified cash or deferred arrangement if Section 2 of the Bill becomes law. If a significant number of employees will not be able to participate in a meaningful way in such an arrangement, a likely fact under the provisions of Section 2, the expansion of the thrift plan may not be undertaken.

It seems anomalous that at a time when this country needs to encourage savings and within months after the Congress enacted a far reaching law to facilitate savings and to stimulate capital formation that serious consideration is being given to a proposal which will have an adverse impact on savings and capital formation. Pension funds provide one of the most significant sources of capital available in the country. Passage of this Bill, however, will have a deleterious effect on the growth of this valuable source of capital.

3. Loans to Employees (Section 3 of the Bill).—Part of Section 3 of the Bill proposes to treat loans to employees from elected contributions made under a qualified cash or deferred arrangement under Internal Revenue Code section 401(k) as distributions. While Public Service does not now have a qualified cash or deferred arrangement, it is planning to institute such a feature as part of its qualifed thrift plan. In order to be able to attract broad participation by low and middle income employees Public Service believes that a loan provision would be most beneficial. Employees will more readily participate in a program of deferred saving if they know they can have access to such funds. Distributions from a section 401(k) plan are able to be made before separation from service only for reasons of financial hardship. If a participant cannot qualify for a hardship distribution yet has a real need for funds, he or she should be able to rely on the plan funds credited to his or her account under such a plan for a loan. Loans from 401(k) plans and other types of plans can be be made only if stringent requirements contained in ERISA and the Code are met. There must be a bona fide indebtedness or else the loan will be treated as a distribution, in which case the 401(k) arrangement might be disqualified. A reasonable rate of interest must be charged. The loans must be adequately secured and they must be available on a nondiscriminatory basis.

On May 18, 1982, John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy, testified before this Committee in opposition to an increase in the penalty tax imposed on early withdrawals from individual retirement arrangements from 10 percent to 15 percent. He reasoned that an increased withdrawal penalty will deter the use of IRA's and deductible employee contributions by low and middle income individuals. He stated that there is a need to make special efforts to encourage use of IRA's and DEC's by these groups. Since low and middle income individuals typically have limited cash resources available when they face hardship or financial emergencies, their IRA's or DEC's may constitute their most significant cash resources. If withdrawals are subject to increased penalties, he reasoned, such individuals will be less likely to use IRA's or DEC's.

This line of reasoning is applicable with equal force to the allowance of loans from qualified cash or deferred arrangements and other plans. Participants in qualified cash or deferred plans may be able to obtain funds needed for a hardship or emergency under the hardship withdrawal provision of the plan. However, the plan sponsor will of necessity have control over the determination of whether the participant does in fact have a hardship. The sponsor may or may not recognize the participant's need as a hardship and thus, the participant has no way of being assured when making the decision to participate or not whether he or she can obtain the funds in his or her account unless the plan has a loan feature. If it does, the participant can rely on that fact in electing to defer part of his or her pay under the plan. If a participant cannot be certain that he or she can have access to the funds in his or her account the participant, particularly the low and middle income participant, may be inclined not to participate. Consequently, treating loans from elective contributions made to a 401(k) plan as distributions will have an adverse effect on the level of participation by individuals in such plans.

Public Service, therefore, vigorously opposes any limitations on plan loans like those contained in Section 3 of the Bill. Since present law contains adequate restrictions and limitations on loans, additional unnecessary and counterproductive restrictions should not be enacted.

4. Social Security Integration Rules (Section 4 of the Bill).—The coordination or integration of Social Security benefits with qualified employee plans is a detailed, complex matter involving many legal, actuarial and practical considerations. When the Bill was introduced Congressman Rangel stated that "under present law some would argue that the tax qualification rules for pension plans allow excessive reductions of plan benefits or contributions for rank and file workers in recognition of employer-provided social security benefits." Cong. Rec., H. 2353 (May 19, 1982). This is the extent of the analysis offered to justify the radical changes proposed by the Bill on this matter. The proposed rules are said to be simpler and more precise and a safe harbor test is offered.

Public Service objects to the provisions of Section 4 of the Bill affecting the Social Security integration rules. The existing integration rules were developed over a long period of time after careful study and deliberation. It would be unconscionable to change such rules without similar careful analysis of what problems the current rules cause and how the new rules would affect integrated plans.

While "some" might argue that the present tax qualification rules are unfair, Public Service believes that radical changes in such rules should be based on actual facts and studies, not conjectures.

Public Service, as mentioned, maintains an integrated qualified defined benefit pension plan. It is fearful that the new rules would severely impact the continuance of the benefit formula in such plan. This could cause a reduction in benefit levels for many middle income individuals.

Many proposals to modify the integration rules have been made in recent years, none with success. One reason for this lack of success is that it has not been shown that the present rules are unfair. In the ERISA process a Senate bill (S. 1179) would have affected the integration rules. After further deliberation the Senate Finance Committee concluded that further restrictions on integration would be counterproductive and have the effect of dampening interest in the establishment of qualified pension plans by some corporations. Legislative History, 1879. In the final stages of the ERISA process a simple two-year freezing of the wage-base was adopted as part of the Conference Report. Within a matter of days a deluge of opposition developed against this limited action, which led the Congress to delete the proposed restrictions. Legislative History, 4731-2.

It is clear that the Social Security integration rules are an important component of the private pension system. However, Public Service does not believe there is a demonstrated need to change the existing rules, as the impact could be counterproductive. Furthermore, Public Service does not believe the proposals provide simplicity; on the contrary, new guidelines would have to be developed to implement the new rules and employers would be required to live with two sets of rules for many years.

5. Statutory Fringe Benefit Plans (Section 7 of the Bill).—The Bill would provide new nondiscrimination rules applicable to statutory fringe benefit plans. These rules would impose complex and burdensome requirements on certain welfare plans and thus would impose substantial additional costs and administrative complexities without justification. there has been no showing that the present rules governing the included statutory fringe benefit plans are being abused. Likewise, there has been no demonstration that these new rules are needed in order to expand the level of benefits to a broader group of employees. On the contrary, there is reason to believe that imposition of new, nondiscrimination rules on welfare plans will prove counterproductive. If so-called "key employees" are going to have to recognize income on their entire pro rata share of benefits, is there then any reason for such key employees to maintain welfare plans for their rank and file employees? Certainly responsible employers will continue to maintain welfare plans for their employees but are all employers responsible in this sense when it may prove too costly or burdensome?

Public Service, therefore, opposes the provisions of the Bill which would impose new nondiscrimination standards to statutory fringe benefit plans. the additional cost and paperwork necessary to determine whether a particular plan does or does not meet the nondiscrimination rules more than offsets any real or imagined increase in benefits to be gained by low and middle income employees.

6. Conclusion.—Public Service believes H.R. 6410 is ill-conceived and should not be enacted into law. The provisions of the Bill dealing with limits on contributions and benefits, loans to employees, Social Security integration and statutory fringe benefit plans would likely cause irreparable harm to the private pension and benefits system. The Ways and Means Committee should not steamroll a Bill of such importance through the legislative process for the sake of expediently raising what is a relatively small amount of revenue. Prudence dictates that this Bill be defeated.

Sincerely yours,

WILLIAM L. SOLLEE.

STATEMENT OF FRED R. EDNEY, VICE PRESIDENT, CORPORATE ADMINISTRATION AND PERSONNEL, REYNOLDS METALS CO.

I. INTRODUCTION

Reynolds Metals Company is a major worldwide producer of aluminum and aluminum products. Reynolds is the second largest aluminum company in the United States and the third largest in the world. Founded in 1928, Reynolds now has more than 50 domestic operating locations, 80 sales offices, and subsidiaries and associated enterprises operating abroad in 19 countries. Reynolds has assets of more than $3 billion, with 29,000 shareholders and approximately 24,000 employees.

Reynolds currently provides retirement benefits for its employees through a qualified defined benefit pension plan for salaried employees and a number of separate qualified defined benefit pension plans negotiated for its hourly employees. In addition, Reynolds maintains a qualified savings plan and a qualified stock ownership plan. All of these qualified plans will be adversely affected by the proposed Pension Equity Tax Act.

With respect to Reynolds' plans and its goal of providing adequate retirement income for its employees, we specifically oppose H.R. 6410 for the following reasons:

It is premature for Congress to revise the tax framework for employer financed pension plans prior to studying the recommendations of the National Commission on Social Security Reform which is to submit its report by the end of this year;

The proposed changes in the Social Security integration rules will undercut the anti-discriminatory design of Reynolds' benefit formula;

The proposed limits on contributions and benefits will leave many Reynolds employees without adequate retirement income; and

The proposed repeal of the automatic cost-of-living adjustment on limitations will erode the value of all pension benefits with the greatest impact falling on lower paid employees.

II. THE ISSUE INVOLVED IN H.R. 6410 SHOULD BE CONSIDERED IN CONNECTION WITH THE RECOMMENDATIONS TO BE MADE BY THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

H.R. 6410 proposes changes that are closely related to the issues being studied by the National Commission on Social Security Reform which was created to develop recommendations for restructuring the entire Social Security system. It is expected that many changes will be made in the system as a consequence of the Commission's work. Because of the interrelationship between company pension plans and the Social Security system, it would be premature for Congress to act now to revise the tax framework for private pension plans.

III. INTEGRATION RULES WILL UNDERCUT ANTIDISCRIMINATION DESIGN OF REYNOLDS' BENEFIT FORMULA

Reynolds' pension plan covering salaried employees provides a benefit which is integrated with Social Security through an "excess" formula design. The benefit formula was carefully designed to provide fully adequate retirement benefits to all employees. This is achieved by using reverse integration (decreasing the rate of accrual as compensation above the average amount covered by Social Security increases) and by providing two formulas (one more beneficial to lower paid employees by giving more credit to earnings below the covered compensation amount). The formula producing the higher benefit for any employee is used to determine the benefit for that employee.

As a result of careful design and compliance with the existing discrimination requirements in the Internal Revenue Code, Reynolds has achieved both equitable and generous benefit levels for all salaried career employees.

As an example, the estimated retirement income available for a Reynolds career employee retiring today at age 65, who earned $15,000 in his last year of employment would be $5,300 a year. His Social Security benefit would be approximately $7,700, for a total of $13,000 a year. This represents 87 percent of his pre-retirement income. A Reynolds employee earning $50,000 in his last year of employment, retiring at age 65 today, would receive approximately $24,500 in plan benefits and $8,100 in social Security benefits for a total of $32,600, or 65 percent of his pre-retirement salary.

In 1979, the President's Commission on Pension Policy was directed to study retirement systems in our nation and develop recommendations. In 1980, the Commission reported a number of findings which led to recommendations that the following replacement percentages are needed to provide adequate retirement security for married retirees:

Replacement objective

Preretirement pay:	*Percent*
$6,500	86
$10,000	78
$15,000	71
$20,000	66
$30,000	60
$50,000	55

As indicated, the Reynolds' plan provides a better benefit for its lower paid employees, vis-a-vis the Commission's replacement objectives, than it does for its higher paid employees. Moreover, the Reynolds benefits illustrated above include a continuation of 25 percent of the benefit to a surviving spouse at no cost to the employee.

The proposed changes will effectively eliminate the option of using an "excess" formula such as the formula now used by Reynolds. While Reynolds could conceivably design a new plan to achieve the same objectives, it is neither reasonable nor cost effective to require a major restructuring of a plan which, in full compliance with the law, has achieved the goal of providing fully adequate retirement income for the full spectrum of Reynolds' employees.

The current integration rules have governed plan design for many years. While nearly everyone agrees that they are unnecessarily complicated, it does not follow that they have resulted in abuse. Thus, Reynolds does not feel that they should be discarded, particularly after less than a month's review.

Finally, the bill is likely to result in a substantial amount of "grandfathering." The bill would leave intact for many employees the present integration rules applicable to defined benefit plans. The new rules would have to apply only to employees who become participants in existing plans on or after January 1, 1984. Many companies will find it untenable, however, to have different benefits for former and new participants. Therefore, the need to amend plans will extend far beyond simply imposing the new requirements on new participants. "Excess" integrated plans, in particular, would have to undergo a complete transformation; it would be virtually impossible from an employee relations view to maintain "excess" integration for current employees and impose offsets on newly hired people.

IV. REDUCTIONS IN LIMITATIONS ON CONTRIBUTIONS AND BENEFITS WILL LEAVE REYNOLDS' EMPLOYEES WITH INADEQUATE RETIREMENT SECURITY

If enacted into law, the bill would reduce the maximum pension payable from a defined benefit plan from $136,425 (for 1982) to $90,000. Annual contributions to a defined contribution plan would be limited to $30,000 instead of $45,475 (for 1982). These limitations affect both high paid and low paid employees adversely.

As concluded by the President's Commission on Pension Policy, high paid employees need a certain percentage of their pre-retirement income to provide adequately for their income needs, although the percentage needed is lower than for lower paid employees. Setting limitations too low to allow qualified plans to provide necessary benefits for high paid employees unfairly discriminates against these employees.

As a result, the use of nonqualified "ERISA excess" benefit plans would be dramatically increased. Reynolds currently maintains an excess plan and would be forced to provide substantial benefits for high paid employees through the excess plan in order to provide adequate retirement benefits to all employees. Because these nonqualified plans are permitted to discriminate, there would be a substantial loss of retirement income for lower paid employees who would not be covered under the excess plan.

Additionally, because nonqualified plans are generally not funded, there could be a substantial drying up of new capital in the country's organized financial markets. Further, because the management of a company would receive most of their retirement benefits from a nonqualified excess plan, they might be disinclined to maintain a generous qualified plan largely for the rank-and-file employees.

V. THE REPEAL OF AUTOMATIC COST-OF-LIVING ADJUSTMENTS WILL ADVERSELY AFFECT LOW PAID EMPLOYEES

Under H.R. 6410, the dollar limits would contain no cost-of-living adjustments. For that reason, along with many others, the bill is not what its sponsor intended; its adverse effects would not be limited to executive-level employees.

For example, consider a representative pension plan that provided about 45 percent of final pay to career employees. Currently, a retiring employee with earnings of $200,000 receives a $90,000 pension—the exact limit under the Act. Assuming the plan never changed, anyone at $200,000 in the future would also bump into this limit. How many employees will ever reach such a pay level?

The answer is, quite a few. If future inflation rates average nine percent, and the company grants annual merit and promotional increases of only four percent, the combination of pay raises (13 percent a year) will subject all of the employees described in this table to the bill's maximum:

Current age:	*Current pay*
59 or less	$100,000
53 or less	[1] 50,000
49 or less	[1] 30,000
46 or less	[1] 20,000
40 or less	[1] 10,000

[1] Or more.

(The problem would be even more acute for employees hoping to retire early; the foregoing numbers assume that retirement takes place at age 65 and the full $90,000 limit is available.) Thus, even the middle salary and low salary employees will be affected by the repeal of the cost-of-living adjustments. However, while most employees' benefits will be eroded by the repeal, again top management will have any reduction in benefit picked up through an "ERISA excess" plan. Thus, it is the low paid employees who will feel the biggest impact.

VI. CONCLUSION

Irrespective of its objectives, the ultimate effect of enactment of the bill would be to prohibit adequate retirement security for many employees, reduce the amount of employer dollars spent on pension benefits for all employees, require substantial amendments to existing pension plans and reduce tax benefits for employers and employees. The bottom line is that a large number of employees in the United States would be left with inadequate retirement security or no retirement security at all. Coupled with the shaky financial condition of the Social Security system and expected benefit cutbacks, the effect of the bill would be to shift a large amount of responsibility for retirement security away from the public system and the private employer to the shoulders of the individual. Obviously, those least able to shoulder the responsibility are the lower paid employees, the very group for whom the bill purports to seek equity.

We urge further study of the need for legislation in this area. If it is ultimately determined that legislation is needed, it should be more carefully drawn and considered in connection with action to implement recommendations of the National Commission on Social Security Reform. In order to eliminate the potential for abuse by a few, it should not be necessary that we all be required to pay more for fewer benefits.

STATEMENT OF THE RISK & INSURANCE MANAGEMENT SOCIETY, INC.

The Risk and Insurance Management Society, Inc. is dedicated to the advancement of professionalism in the field of risk management. It provides a forum for the exchange of ideas and information among corporate risk managers, and strives to facilitate the management of risk and employee benefits programs to preserve corporate assets and profits.

A not-for-profit organization, its membership is comprised of more than 3,700 corporations, institutions and governmental bodies in 73 chapters located throughout the United States and Canada. Corporate members include 90 percent of the top Fortune 1,300 companies.

The federal budget deficit now anticipated is of great concern and RIMS supports the basic effort to reduce that deficit but RIMS believes that this objective can not justify hasty enactment of broad sweeping changes in the benefit plans applicable to any segment of the employees in the work force. The bill introduced by Mr. Rangel involves areas that are very technical and so far reaching in their implications that they should not be part of a tax raising action. Social security integration, for example, is a subject which has been studied for a long time and a satisfactory solution has still to be achieved.

RIMS believes that the proposed cutback in the current annual maximum contribution of $45,475 under section 415 of the Internal Revenue Code (IRC) and the corresponding cutback of $136,425 maximum defined pension benefit will create an unintended result, as will the elimination of the indexing of these amounts. Our serious concern is the potential reduction in future benefits for rank and file employees by employers who decide to redesign their benefit plans to provide all participants a benefit limited to the same lower proportion of compensation that would be imposed upon higher paid employees. Further, the reduction of the "1.4 rule" to a "1.0 rule" easily could result in lowered employer contributions to profit sharing plans or their total elimination. Clearly such results are diametrically opposed to the future enhancement of private pension plans.

RIMS is concerned also that the proposals relating to welfare pension benefits need much more study. Many employers have maintained different benefit levels for different classes of employees for very valid reasons. Some benefits, such as wage replacement, vary by the length of service as well as by job level. It is very questionable whether there is a need to broaden non-discrimination rules in this area.

In conclusion, RIMS strongly urges that any changes affecting employee benefit plans only be made after a detailed analysis of their total impact.

THE ROUSE CO.,
June 8, 1982.

MR. JOHN SALMON,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I am very concerned with the intent of the bill introduced by Congressman Rangel. As a responsible corporation, we have provided a comprehensive program of insurance and retirement for our staff. Our programs apply to everyone regardless of their position, which we believe to be the proper approach.

My concern is that the legislation proposed will result in the "baby being thrown out with the bathwater." It seems very unlikely that people covered by benefit plans will be well served by additional legislation conceived in an attempt to avoid the unpopular, but in fact more necessary, decisions concerning Social Security financing and benefits.

Sincerely,

WILLIAM D. BODEN,
Vice President, Director of Personnel.

STATEMENT OF CHARLES M. LAX, ON BEHALF OF RUBENSTEIN, ISAACS, LAX & BORDMAN

Mr. Chairman and members of this Committee, thank you for the opportunity to present this statement to your Committee. My name is Charles M. Lax and I am presenting this statement on behalf of the law firm of Rubenstein, Isaacs, Lax and Bordman, Professional Corporation, of which I am a member. My firm is located in Southfield, Michigan. After reviewing H.R. 6410 or the so-called "Pension Equity Tax Act of 1982," I feel compelled to prepare this statement and urge the defeat of this legislation. Simply put, H.R. 6410 is misguided and may trigger the end of the private pension system. This would, of course, be occurring at the same time that our social security system is in jeopardy.

A significant portion of my firm's practice includes the representation of closely-held corporations, including professional service corporations. I estimate that our firm represents between 300 and 400 employers who maintain approximately 500 qualified retirement plans. These employers employ many thousands of employees, who today enjoy the benefits of these qualified retirement plans.

Congressman Rangel, in introducing H.R. 6410, stated that the purpose of the legislation is to "provide greater tax incentive for the comprehensive inclusion of the broadest possible class of employees in tax subsidized pension and statutory fringe benefit plans." After reviewing the proposed bill and drawing upon my experience in representing closely-held businesses, I believe this objective will not be met. The proposed modifications to the social security integration rules and other limitations imposed by the legislation will, at best, cause the reduction of retirement benefits across the board, and more likely cause the termination of numerous qualified retirement plans, rather than broadening their benefits.

Legislation to broaden benefits to employees has been adopted previously, and I believe failed miserably. For example, Section 376 of the Revenue Act of 1978 added Internal Revenue Code Section 105(h). This section was designed to impose non-discrimination rules upon uninsured medical reimbursement plans. Instead of broadening the coverage for rank and file employees, my experience has been that up to 90 percent of my firm's corporate clients terminated their uninsured medical reimbursement plans, thereby causing many rank and file employees to lose their existing benefits.

The provisions of the proposed legislation calling for the reduction of maximum plan contribution or benefit limits initially appears to be appealing. For example, reduced contributions should mean reduced tax deductions and therefore higher tax revenues. Furthermore, the reduction of maximum benefits and contributions should only affect the highest paid and not rank and file employees. This legislation, however, will not produce these results. Instead of retirement plan contributions, highly paid individuals will seek out additional tax shelters, thus further curtailing tax revenues. This, of course, occurs at a time when tax shelters are already proliferating at too great a rate, speculative or even abusive shelters are common, and our entire tax appeal and Tax Court system is overrun by tax shelter cases. Additionally, you can be sure that if the maximum benefits are reduced for high paid individuals, similar across the board reductions will be made by the employers for all other employees.

Another aspect of this legislation is curious. In an era of government "deregulation" this legislation puts further restraints and restrictions upon the small businessman. My experience indicates that in today's environment, many small businessmen will not tolerate further government regulation of the nature called for by this bill. The costs of compliance with this legislation will be burdensome. Small businesses have barely endured the process of ERISAfying their retirement plans. This has meant, and will continue to mean, constant plan amendments to comply with new laws and regulations and numerous filings and disclosures. I believe that certain employers will terminate their plans merely because they are tired of the costs and burdens of maintaining their qualified status.

Finally, I wish to express the fact that I am personally offended by the continued and blatant discrimination imposed by the tax laws against professionals. It appears that the professional is being set up as a "political scapegoat" by this legislation. In the name of fairness, rules will be imposed against the professional that will not apply to other commercial enterprises or even other service businesses. No sound justification can be set forth why a doctor or lawyer's corporation should be treated less favorably than an incorporated dry cleaner, shoe store or insurance agent.

For some reason, certain members of Congress believe that professionals incorporate their practices solely for tax purposes and use their qualified retirement plans as a "tax dodge." This is just not the case. Professionals incorporate for the same reasons that other businessmen incorporate. For example, Corporations provide limited liability to their owners, easy methods by which ownership interests may be transferred or disposed of, continuity in the event of the owner's death, disability or sale. Furthermore, to the extent that the corporate qualified retirement plans do provide tax advantages, professionals merely utilize these benefits in the same manner that other businessmen do. Finally, if this portion of the bill passes, I believe that it may provide the incentive for some enterprising legislator to suggest another means of raising tax revenues, that is, by establishing two different sets of tax rates. The first set of rates would apply to all taxpayers except those to which a higher second set of rates would apply. That second higher set of tax rate would, however, only apply to professionals.

I appreciate the opportunity to participate in these hearings. In conclusion, however, I urge that this legislation be soundly defeated. While some provisions may appear to be politically expedient on their face, an analysis of their overall affect must lead to the conclusion that many American employees will suffer the loss of private pension benefits at the same time their social security benefits are in jeopardy.

STRINGHAM, LARSEN, MAZURAN & SABIN,
Salt Lake City, Utah, June 17, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, Longworth Building, Washington, D.C.

DEAR MR. SALMON: I am writing for purposes of expressing concern and opposition to the approach and effect of proposed HR 6410 upon which, I understand, hearings have just been completed through the Ways and Means Committee. It appears to me that this proposed legislation, in attempting to resolve perceived problems in the handling of pension funds, does not take into consideration the more detrimental aspects of the bill itself. Specifically my concerns include the following:

1. It is my impression that portions of that bill are intended to prevent abuses through borrowings by participants from pension plans. These types of abuses are already under the broad jurisdiction and control, and subject to severe penalties, through enforcement proceedings both by the Internal Revenue Service and Department of Labor under current law. The appropriate procedure should rather be through the existing enforcement mechanisms which provide substantial penalties for such abuses, rather than a manipulation with the underlying intent and benefit of the present pension acts which have good and valid purposes behind them.

2. It appears that this legislation presumes that, because there have been some abuses, these abuses are being carried out by entire classes of people. However, most people genuinely are attempting to comply with both the spirit and letter of the law; and they would certainly be penalized if an overreaction occurs penalizing the many because of the actions of a small minority.

Very truly yours,

NEIL R. SABIN.

STATEMENT OF SAMUEL J. SAVITZ & ASSOCIATES, INC.

INTRODUCTION

This statement is made on behalf of the firm of Samuel J. Savitz & Associates, Inc., a Philadephia-based consulting and actuarial firm that administers more than 1,200 retirement plans, covering thousands of employees.

BACKGROUND

At an earlier appearance before this Committee, I testified in support of the enactment of the Employer Retirement Income Security Act of 1974 (ERISA). At that time, I favored "structured" legislation in the belief that the benefits to be gained by the larger number of participants far outweighed what I then perceived as the modest consequence of the small number of plans that would terminate. This, of course, was not the case, for it is abundantly clear that others who testified were more accurate in their assessment that enactment would be followed by large-scale plan terminations. And as a result, tens of thousands of employees were denied continuing pension coverage.

Yet, on balance, ERISA did more good than harm, for its enactment assured participants of surviving plans that their pension promise would be fulfilled.

COMMENTS ON PROPOSED LEGISLATION

In his introductory remarks, Representative Rangel expresses the two principal objectives of the Bill. One is to provide greater tax incentives, the purpose of which is to expand the private pension system. The second is to reduce the excessively high tax limits on tax-free accumulations.

No reasonable person could quarrel with these objectives, nor could any reasonable person fail to conclude that these objectives are in conflict with each other: how can there be greater tax incentives, which Congressman Rangel acknowledges is needed to broaden and expand the private pension system, if existing tax incentives are reduced? And if the position that the Congressman postulates, namely that further incentives are needed to expand the system, then it would follow that the withdrawal of existing benefits would cause the private pension system to contract.

Our pension system is a voluntary one and although perhaps imperfect by its failure to achieve universal coverage, it is nonetheless a viable system that provides meaningful benefits to millions of American workers. This sucess is attributable to the foresightedness of the Congress, in offering tax incentives to stimulate voluntary action by private industry, resulting in thosuands of plans covering millions of employees, and which today represents the single largest source of capital available to American industry.

If it can be established that the growth of the private pension system has been greatly influenced by the tax incentives offered by Congress, it must necessarily follow that the withdrawal of these incentives will bring this growth to a halt, and more likely, cause the system to contract. If there is any question as to the validity of this assessment, we need only look back to the period immediately following the enactment of ERISA, 1974 through 1980, during which period, for the first time ever, more plans were terminated than adopted.

ANALYSIS OF TAX INCENTIVES

When a corporation adopts a plan, particularly a closely-held commercial or professional corporation, the shareholders accept a reduction in current compensation. Without a plan, at least 50 percent of the amounts so received as compensation would be retained after taxes. To the extent that the tax burden is perceived too great, tax shelters would be explored and resultantly, tax collections would undoubtedly be less tnan 50 percent.

By implementing a retirement plan, shareholder-employees accept compensation reductions and as a result, the tax on such reduced salary is deferred. However, there is a "price" to be paid for this deferral of tax, which is that plan benefits must be offered on a nondiscriminatory basis to all other employes of the corporation. Thus, of the compensation reduction accepted by the shareholder-employee, other employees to some extent benefit.

When plan assets are distributed, whether in the form of retirement, death, disability or severance benefits, the recipient is taxed. In the case of shareholder-employees, it is likely that the tax will be at the same bracket that would have been applicable had there been no deferral. In the case of lower paid employees, a significantly lower tax bracket would likely be applicable.

Thus, the "benefit" (a tax incentive) to shareholder-employees is but the deferral of taxation, and the "price" paid for such deferral is that other employees must participate in the plan on a nondiscriminatory basis. Exhibit "A" has been developed to demonstrate that the ultimate value of the plan to the shareholder is not materially greater (and in some instances less beneficial) than were no plan adopted, and in every instance there is a benefit to employees.

ADVERSE EFFECTS OF PLAN TERMINATIONS

The most significant impact of plan terminations would be the loss of pension benefits by those employees covered under plans that would be terminated. Although there is no way to accurately predict the magnitude of this impact, it would be reasonable to assume that hundreds of thousands of employees could ultimately be effected.

The capital markets of this country would also materially suffer, in that the pool of assets accumulated under pension plans has become the single greatest resource available to American industry.

The banking community would also materially suffer in that a reasonable scenario would aniticipate the smallest of companies terminating plans, these being the ones that principally invest in savings certificates. To the extent that any of these plans terminate in order to raise cash to make liquidating distributions, savings certificates would undoubtedly be redeemed. And the segment of the banking industry likely to be most affected by such redemptions would be savings and loan associations, the segment of industry that in recent years which has experienced considerable difficulty in raising funds.

Government, too, would be adversely affected in at least two ways. One relates to the additional liabilities that would be transferred to the Pension Benefit Guaranty Corporation, resulting from additional plan terminations. Undoubtedly, the weakest plans would first terminate and this would exacerbate the difficulties presently being experienced by the PBGC. The second is perhaps less direct and relates to the acknowledged burden that would befall private industry were Social Security reform to become a reality. This conclusion was also reached by the authors of an information paper prepared for the use by the Special Committee on Aging of the United States Senate entitled, "Linkage Between Private Pensions and Social Security Reform." To the extent that the existing Social Security integration formula is tinkered with, the burden of American industry becomes even greater, thereby contributing to still further plan termination.

SUMMARY AND CONCLUSIONS

The adoption of this proposed legislation would most certainly be followed by a significant number of plan terminations. This in turn would adversely affect one, employees who will as a result be denied continuing pension coverage; two, American industry that looks to pension assets for the purpose of financing its capital expenditures; three, the construction industry and the banking community; and four, indirectly, government by reason of the likelihood that general revenues will be required to meet the liabilities transferred to the Pension Benefit Guaranty Corporation.

In order for the American private pension system to further grow, new incentives should be offered, rather than the withdrawal of existing ones. New incentives will result in an expanding private pension system and millions of employees will look to this system for their ultimate security. American industry will also benefit by a continuing and expanding source of capital. And not to be overlooked is the benefit that our nation will derive from greater savings, less consumption and ultimately, a declining inflation rate.

Respectfully submitted,

SAMUEL J. SAVITZ.

Exhibit "A"—Comparison of alternative saving plans [1]

Without plan:	
Additional compensation	$10,000
Net (after tax) savings [2]	5,000
Net accumulation [3]	286,375
With plan:	
Shareholder's credit	7,500
Net accumulation [4] and [5]	270,200

[1] Based on $10,000 for 20 years.

[2] After taxes, assuming a 50 percent tax bracket AND disregarding possible tax-shelter.

[3] Assumes an annually compounded, tax-free return of 10 percent.

[4] Assumes that 75 percent of the contribution is credited to shareholder-participant and remaining 25 percent credited to all other employee-participants.

[5] Assumes an annually compounded return of 12 percent.

SCHERING-PLOUGH CORP.,
Kenilworth, N.J., June 10, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: We in industry who deal with employee benefits daily in the corporate environment, and who are concerned with providing for the legitimate needs of our employees at a reasonable economic cost are greatly concerned about the impact of this legislation as proposed.

We think further careful analysis of all aspects of the bill is needed, but are particularly concerned about the following:

1. The proposed social security integration rules seem to us certain to produce inequities and administrative complexities that are unnecessary. Although it may seem on the surface to be logical, it ignores the fact that FICA contributions during employment pay the benefits for those that have already retired and are not really proportional to the benefits of current employees. There are much simpler ways to achieve these desired and reasonable objectives.

We urge reconsideration of this proposal and further analysis.

2. The limits on executive benefits will have considerable side effects in pushing executives and corporations into various avenues of job changes, tax shelters and other uneconomical activities, while gaining little additional tax revenue. The present arrangements, at least in large corporations, are quite straightforward and generally fair to all.

Sincerely,

HARRY P. CULVER,
Staff Vice President, Compensation and Benefits.

S. C. PENSION SPECIALISTS, LTD.,
Chicago, Ill., May 25, 1982.

Hon. DANIEL ROSTENKOWSKI,
Chairman, Ways and Means Committee, House of Representatives, Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI: As a member of the Pension Administrative and Actuarial Consulting community, I am compelled to write you regarding the Pension Equity Tax Act of 1982 (H.R. 6410) introduced by Congressman Charles D. Rangel, a member of the House Ways and Means Committee. I am made to understand that there will be hearings on H.R. 6410 before the House Ways and Means Committee on June 8, 1982. Given the closeness of the hearing date, my remarks take on a sense of urgency. We are deeply concerned about several objectionable provisions of the Bill, the inadequate notice of hearings, and the incongruity of the Bill's tenor with that of the Administration's philosophy of "getting Government off the backs of business."

We believe Congressman Rangel's Bill blindsights itself to the realities of the private pension system. It seems to us that Congress has been enacting laws regarding the private pension system for over 8 years. Each time new legislation is passed, new plan amendments are required. And, in addition, nonproductive costs are incurred. Now again, plan sponsors are faced with the threat of still more nonproductive costs.

It seems to us that many of the plan's provisions bear no reasonable relationship to the reality of the private pension system. Its provisions discourage the creation of pension plans. Very few of our plans currently are faced with the maximum limitation on benefits and contributions under Section 415 of the Internal Revenue Code. There is no justification to ask their plan sponsors to again amend their plans. Enough is enough.

We have received substantial negative feedback from our clients and expressions of concern. We are deeply concerned about many of our plans terminating. Moreover, the suggestions regarding changes in the Social Security integration rules are totally ludicrous. The rules are already unduly complicated and complex. The further delegation of broad general legislative authority to the Secretary of the Treasury is not only unconstitutional, but it also creates unpredictability for the private plan sponsors. We need more predictability not less. We caution you that the Rangel Bill causes a threat to the very heart of the private pension system, employee retirement benefits generally, and the best vehicle for the formation of capital and reindustrialization of our country.

It seems to us that H.R. 6410 should be defeated. It penalizes economic achievement. It destroys personal incentive as well as the incentive of the small plan sponsor to set up plans for rank and file employees. Needless to say, I recognize that there are areas requiring reform in the private pension system. The "buckshot" approach of H.R. 6410 comes no place close to bringing about necessary reform. We encourage you to oppose H.R. 6410. Alternatively, we ask that you encourage the House Ways and Means Committee to provide full and broad based hearings so as to bring forth input from all sectors of the economy.

We caution that a favorable vote by the House Ways and Means Committee on H.R. 6410 could trigger long-term negative repercussions not only in the private pension system but also to the national economy. We ask your help.

Very truly yours,

DONALD S. CARNOW, *President.*

HUNTINGTON WOODS, MICH., *June 2, 1982.*

Mr. JOHN SALMON,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I understand that the House Ways and Means Committee will hold hearings on HR 6410, a bill proposed by representative Charles Rangel.

I wish to protect in the most vigorous way possible the provisions radically altering the funding and distribution of pension and profit sharing plans. I believe it to be grossly unfair for the Congress to change the rules in mid-game, after I and hundreds of thousands of other citizens have already made plans based on agreed upon principles.

Furthermore, the proposed reduction of benefits, especially when coupled with the high legal and administrative costs necessary to maintain a qualified profit sharing plan, can only discourage the formation of new pension plans and also encourage the dissolution of current ones. With our social security system in increasing jeopardy, these plans might prove to be the only source of income for large numbers of people.

I would appreciate your conveying my sentiments to the members of the committee you represent.

Sincerely,

DONALD SHAPIRO, D.D.S.

SOUTH CAROLINA NATIONAL CORP.
Columbia, S.C., June 17, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: Management of South Carolina National Corporation respectfully requests that the following comments be entered into the written minutes of the June 8, 1982, public hearing of H.R. 6410, The Pension Equity Tax Act of 1982, before the House Ways and Means Committee. These comments are made on behalf of the 2785 people in South Carolina, North Carolina and Virginia who are employed by South Carolina National Corporation and its operating subsidiaries: The South Carolina National Bank, Provident Financial Corporation and SCN Advisory Corporation. The future retirement security of these employees and their families depends heavily on the liberal benefits provided by the South Carolina National Corporation Pension Plan and Savings and Thrift Plan. These benefits are available to all of our employees and would be significantly reduced by both the obvious and the more subtle effects of H.R. 6410. Consequently, we feel compelled to voice our objections to this bill.

Should H.R. 6410 become law, we are convinced that its effects would be more harmful and more widely felt than any of its current proponents probably can imagine. At a time when cuts in Social Security benefits seem most inevitable, those of us planning for retirement must look to private pension plans and other private employee benefit plans to fill in the further gaps to be left by Social Security. Under H.R. 6410 the possibility of such relief would be severely limited not only for executive-level employees, but for a very broad cross-section of the working American public.

Under current inflationary trends and an assumption of very conservative merit and promotional increases, the dollar limits that H.R. 6410 would impose, with no provisions for cost-of-living adjustments, would affect not only those employees who are 59 years old and making $100,000 per year but also reach down to the 40-year-old employee currently earing only $10,000 per year. Such prospects are quite disconcerting.

Aside from the far-reaching effects to be felt from these dollar limitations, H.R. 6410 would impose a more dramatic cutback, although more subtly implemented, through a change in the complex "1.4" rule for employees in two types of plans (e.g., pension and thrift). This proposal would affect a very large percentage of our employees and would very likely lead us and other employers to drop one of the plans. Contrary to the claims of the bill's sponsor, H.R. 6410 will not "provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans", but will tend to halt the trends of recent years toward an increase in retirement benefits and a general broadening of eligibility requirements under retirement benefit plans.

In addition to the specific problems which we believe would be created by the provisions of H.R. 6410, passage of this bill would have an overriding, negative economic impact on industry, government, and the country as a whole. This impact would come from the enormous amount of resources that all employers would be forced to expend in order to bring their retirement benefit plans into compliance with HR. 6410. Such nonproductive use of resources is one of the major problems with our economy today. The productivity which built this nation cannot be restored without the concerted efforts of our Congressmen to eliminate counterproductive legislation such as H.R. 6410.

We appreciate your inclusion of these comments in the official minutes for consideration by the members of the Committee.

Yours truly,

JEAN GALLOWAY BISSELL.

CORAL GABLES, FLA., *June 7, 1982.*

Hon. DAN ROSTENKOWSKI,
Chairman, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

DEAR REPRESENTATIVE ROSTENKOWSKI: I write in my capacity as the President of the South Florida Employee Benefits Council to submit this Statement in lieu of my oral testimony at the public hearings scheduled on the above-referenced Bill. I had timely requested the opportunity of testifying before your Committee, but unfortunately, I was not invited to testify. In accordance with my telephone conversation with Mrs. Lawler of your office on Friday, June 4, 1982, I was assured that this Statement would be distributed to the members of your Committee during the first day's hearings in lieu of my appearing personally. Accordingly, I respectfully requested that this letter be distributed to each member of your Committee on Tuesday, June 8, 1982.

The South Florida Employee Benefits Council is a membership organization comprised of individuals and companies whose primary business involves private pension plans. We have fifty-seven members including attorneys, certified public accountants, plan administrators, plan consultants, actuaries, insurance salesmen and trust officers.

The membership of the organization has unanimously approved my writing you and the other members of the Committee and informing you that we are categorically opposed to the enactment of H.R. 6410 or any similar legislation. We respectfully request that you and your Committee vote against recommending that H.R. 6410 be submitted to the full House.

The members of the South Florida Employee Benefits Council who responded to a request for information have indicated that the total value of the assets in the plans sponsored by clients of the members of the South Florida Employee Benefits Council exceed $500,000,000, and that annual contributions to such plans are in excess of $70,000,000. There are more than 1,700 plans sponsored by such clients and more than 32,500 employees participate therein. If H.R. 6410 is enacted, we estimate that more than 900 of these 1,700 plans will be terminated or curtailed and more than 17,500 of the 32,500 participants will have their pension benefits either eliminated or substantially curtailed. More importantly, the annual contributions to these plans will be reduced by more than $40,000,000 resulting in a reduction in funds for the following sources: savings and loan associations for mortgage investments; capital stock purchases for capital formation; corporate bonds for capital formation;

direct mortgage loans for residential construction. The impact of the loss in capital formation dollars and the long-term adverse impact on the Social Security system cry out for a vote against H.R. 6410.

GENERAL REASONS FOR OPPOSITION

We feel that H.R. 6410 should not be enacted for the following general reasons:

A. The enactment of H.R. 6410 will have an adverse impact on the economic recovery of this country:

1. The inflow of capital formation dollars into the economy will be substantially reduced;
2. H.R. 6410 is directly contrary to the philosophy of the Economic Recovery Tax Act of 1981 which was intended to foster rather than stifle the economic recovery through encouraging capital formation;
3. The federal budget deficit will be increased rather than decreased;
    a. The reduction in income tax revenues resulting from the reduced income associated with the further economic downturn will exceed the anticipated increase in income tax revenues expected from the reduction in deductions for contributions to pension plans;
    b. The anticipated increase in income tax revenues will not occur because the reduced pension contributions will be offset by salaries or other compensatory-type payments and increased use of tax shelters;
    c. Government welfare expenditures will grow as more and more people lose their jobs as the economic downturn worsens.

B. The enactment of H.R. 6410 will increase the dependence on our nearly bankrupt Social Security System;

1. We estimate that approximately 17,500 plan participants in the South Florida area will have their benefits curtailed or lost completely if H.R. 6410 is enacted;
2. Any measurable decrease in private pension benefits, particularly for rank and file employees, will have a catastrophic effect on such participants' ability to cope with the devastating effect of inflation and will place further strains on the Social Security system.

C. H.R. 6410 discriminates against small business and, in particular, certain personal service businesses at a time when small businesses, and particularly personal service businesses, provide the lifeblood of the economy of this country;

D. The enactment of H.R. 6410 will interject a lack of stability in the pension plan system which will cause more and more employers to terminate their plans or fail to adopt new plans;

1. H.R. 6410 effects substantial and far-reaching changes in the private pension plan system within seven years of the most far-reaching pension legislation ever enacted by Congress without the study and planning which preceded the Employee Retirement Income Security Act of 1974;
2. Almost all aspects of H.R. 6410 adversely affect those individuals who determine whether or not a private pension plan is adopted and who bear the direct after-tax cost of providing pension benefits for the rank and file employees.

We believe that the foregoing general reasons constitute good and sufficient, if not conclusive, reasons why you and your Committee should vote against H.R. 6410. However, we also have specific reasons addressed to each Section of H.R. 6410.

SPECIFIC REASONS FOR VOTING AGAINST H.R. 6410

Section 2 (Lower contributions and benefit limits for tax-subsidized annuities, etc.).

Section 2 of the Bill should be opposed for the following reasons:

1. It makes substantial and adverse changes in the well-studied and comprehensive legislation which became effective less than seven years ago through the enactment of the Employee Retirement Income Security Act of 1974;
2. Any limitation on benefits or contributions for the owners of small business will reduce their motivation to adopt or continue any form of qualified deferred compensation plans;
3. Any reduction in the benefits available to the owners of small businesses will cause a disproportionately greater reduction in the contributions or benefits available to the rank and file employees;
4. Any reduction in contributions and benefits, particularly when coupled with the elimination of the automatic cost of living increases, will diminish the benefit of

any form of qualified deferred compensation plan because of the eroding effect of inflation;

5. Section 2 is inequitable because there is no similar legislation being proposed to eliminate automatic cost of living adjustments in Social Security benefits, pensions paid to legislators, pensions to paid to federal judges or pensions paid other federal employees:

6. The elimination of the automatic cost of living increases will result in additional costs, complexity and uncertainty if Congress must act on a periodic basis to increase ceilings in future years;

Section 3 (Loans to Key Employees Treated as Distributions).

Section 3 of H.R. 6410 should not be enacted for the following reasons:

1. The elimination of all forms of borrowing by "key employees" will have a negative effect on certain key industries of the country through the elimination of sources of funds for residential home construction, automobile purchases and similar expenditures which are generally financed through installment-type obligations;

2. Section 3 of H.R. 6410 is overly broad and does not contain adequate guidelines to accommodate the legitimate utilization of private pension plans to provide some form of borrowing capabilities as have been recognized by the courts and the Internal Revenue Service for at least the last thirty years.

Section 4 (Nondiscriminatory Coordination of Plans with Certain Federal and State Retirement Systems).

Section 4 of H.R. 6410 should not be enacted for the following reasons:

1. This legislation is defective because it fails to treat the Social Security program as a whole and seeks to limit the amount of Social Security benefits that can be taken into account in determining whether or not nondiscriminatory benefits are being provided to those benefits purchased by the employer maintaining the plan rather than benefits that are available to the participant from contributions made by all other employers;

2. Section 4 is deficient because it fails to take into account the fact that any given employer is making contributions to the Social Security system for employees who may or may not be presently participating in the employer's private pension plan but may participate in that plan or in numerous other plans in the future;

3. Section 4 is defective because it does not accord with and, in fact, seeks to change the rationale and implementation of the present legislation as set forth in Revenue Ruling 71-446 which Revenue Ruling was based on extensive studies and acturial computations made by the Internal Revenue Service;

4. Section 4 should not be enacted because it is simply unworkable and will not permit any retional basis for giving an employer credit for the substantial benefits that will be paid to rank and file employees under the Social Securtiy system based upon the contributions of numerous employers for innumerable employees over the course of a possible length of service of more than forty years.

Section 5 (Increase in Amount of Self-Employed Retirement Plan Deduction from $15,000 to $30,000; Extension of Certain Rules Covering Owner-Employees to Other Self-Employed Individuals).

Section 5 of H.R. 6410 should not be enacted for the following reasons:

1. The provisions of Section H.R. 6410 dealing with the purported increase in deductions for self-employed individuals do not effect any increase in contributions for the vast majority of self-employed individuals because there is no increase in the 15 percent limitations which is an alternate limitation of the deduction for self-employed individuals;

2. The increasse in the monetary limitation, but not the percentile limitation on deductions for self-employed individuals, will only benefit a miniscule number of super-compensated self-employed individuals who will be able to double their contributions without materially improving the private pension plans available to the remaining self-employed individuals and without effecting any increase in the pension benefits available to the rank and file employees who work for such "super-compensated" self-employed individuals.

Section 6 (Extension of Rules Applicable to Plans for Self-Employed Individuals to Plans of Personal Service Corporations).

Section 6 of H.R. 6410 should not be enacted for the following reasons:

1. Section 6 is an arbitrary and capricious attempt to discriminate against selected small businesses who provide certain limited areas of personal services;

2. Section 6 is contrary to the prior Congressional action in 1969 and 1973 in which similar attempts to discriminate against selected personal service corporations was soundly defeated;

3. Section 6 fails to acknowledge both the judicial and administrative recognition of personal service corporations as legitimate, viable corporations which should be recognized for all tax purposes;

4. Personal service corporations rendering the services set forth in H.R. 6410 are legitimate, tax effective corporations which should be afforded all of the advantages under the income tax law and are subject to all of the disadvantages attendant on carrying on a business in the corporate form such as the aspect of double-taxation, considerations of reasonable compensation, tax on the unreasonable accumulation of income, increased occupational license fees, and increased federal and state employment taxes;

5. The personal service corporations listed in Section 6 of H.R. 6410 provide both an excellent and efficient way for professionals to carry on their practices;

6. The limitation of the effect of Section 6 of H.R. 6410 to certain corporations constitutes an arbitrary, capricious and discriminatory classification of certain personal service organizations without any rational distinction between other personal service organizations;

7. Section 6 of H.R. 6410 is yet another example of an insidious attack by certain representatives of the Internal Revenue Service on professional service corporations, although such attacks have met with almost universal defeat for the last fifteen years and, in fact, the Internal Revenue Service recognized the tax efficacy and corporateness of professional service corporations in Revenue Ruling 70-101 and almost all attempts by the Internal Revenue Service to attack the "corporateness" of professional service corporations in the courts have been defeated since 1970.

Section 7 (Key Employees Required to Include and Income Benefits Provided Under Certain Disciminatory Fringe Benefit Plans).

Section 7 of H.R. 6410 should not be enacted for the following reasons:

1. The provisions contained in Section 7 are already adequately covered under the present Internal Revenue Code as recognized by the fact that many of such nondiscriminatory provisions are suggested for repeal in Section 7;

2. The bias of the entire thrust of H.R. 6410 against the small businessman who must bear the after-tax cost of providing benefits for his employees is again manifested in Section 7 by limiting such nondiscriminatory treatment to "key employees."

Section 8 (Limitation on Estate Tax Exclusions Under Section 2039).

Section 8 of H.R. 6410 should not be enacted for the following reasons:

1. There is no reasonable basis for establishing a $500,000 maximum exclusion under qualified deferred compensation plans;

2. Section 8 is contrary to the legislative philosophy set forth in the Economic Recovery Tax Act of 1981 which was to increase the deductions for estate taxes and to seek to eliminate the estate taxes in the majority of estates;

3. The reduction of the estate tax exclusion will have an adverse impact on the adoption of plans by the owners of small businesses, thereby resulting in the elimination or curtailment of substantial private pension plan benefits for the rank and file employees of such small corporations.

Based upon the foregoing general and specific reasons, and on behalf of all of the members of the South Florida Employee Benefits Council, their clients and the more than 32,500 participants in the more than 1,700 plans sponsored by such clients, you and each member of the Committee are respectfully requested to vote against the referral of H.R. 6410 to the House for further consideration.

Thank you for your attention to this matter.

Respectfully submitted,

South Florida Employee Benefits Council.
Charles P. Sacher, *President*.

Steade Educational Resources Corp.,
Fort Collins, Colo., June 15, 1982.

Mr. John T. Salmon,
Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: The purpose of this letter is to express my concern over bill HR-6410 sponsored by Representative Charles B. Rangel.

It seems to me that this bill hits the already-beleagured middle-income businessperson. This is especially true of the provision to eliminate future cost-of-living adjustments from pension plans. Executives of large corporations have "salary-reduction" plans for tax shelters. Independent business operators working on a cash basis often resort illegally to the underground economy to "protect" themselves from inflationary impacts on their cost of living. I recently spent over $1,000 to set up a corporation and a legal pension plan. Now, some provisions of this plan may be compromised by the pending bill. It seems that a person faces a losing battle in trying to cover oneself in the long run.

I respectfully urge the Ways and Means Committee to think carefully before making changes to existing pension plans on a retroactive basis.

Sincerely,

RICHARD D. STEADE, *President.*

HARRY M. STEVENS INC.,
New York, N.Y., June 18, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways amd Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR JOHN: Indeed this is a "Dear John" letter, for "oh, how I hate to (have to) write". . . but I find it absolutely appalling that a strong endorsement could be given by Mr. John Chapoton, Asst. Treasury Secretary for Tax Policy to the "Pension Equity Tax Act" (PETA), proposed by Charles B. Rangel (D–N.Y.).

Has not enough evidence been presented from the ranks of the Private Pension Industry that the bill would be detrimental not only to the private pension system, but to the overall economy of the United States? From the information I, myself, have been able to gather, it is quite apparent that the general consensus is that this legislation is but a hastily contrived political countermove proposed by Democrat Rangel to penalize the high salaried self-employed professionals, who abuse the numerous loopholes and tax shelters available to certain individuals in the current private pension community. But, the effects on the private pension system on the whole would possibly have catastrophic long term consequences. In the words of Mr. Gerald Facciani, president of the American Society of Pension Actuaries, "the bill would encourage terminations, discourage new plan formation, substantially increase administrative expenses, put greater pressure on the Social Security system and adversely affect the supply in investment capital".

I am sure you would agree that at a stage of the economic cycle in early 1983, the proposed effective date of PETA, when the current recessionary period of our economic cycle would be going through the early stages of a rebound (a view shared by several prominent economists), the ramifications of the above "worst case scenario" would be devastating. In addition, I find it disturbing that the underlying concept of the Employee Retirement Income Security Act of 1974 (ERISA) of expanding the role of the private pension plan system could possibly be undermined in an attempt to generate "a much needed" $1.7 billion in increased federal reserves over a 3 year period. I think the bill's proponents have overlooked the long term consequences of PETA that would penalize the well-funded private pension system in order to generate short term and short lived federal revenue.

A tremendous amount of paper work and needless administrative expenses (an estimated $700 million) would be incurred by the private pension sector in amending existing pension plans. For example, the Rangel bill defines integration limits in terms of the employer purchased Social Security Benefits, not the Social Security Taxable Wage Base, as is incorporated into many defined benefit plans including our own—Harry M. Stevens, Inc. Retirement Plan for Salaried Employees. To attempt to reduce the employees' pension benefit by the portion of his Social Security Benefit purchased only by the employer, as is proposed in the bill, would require a total redesigning of our pension plan at the time when the current financial climate does not lend itself to that end. Even the proposed "safe harbor" rules for defined benefit pension plans would lead to redesign and unnecessary expenses to the private pension sector. Given the complexity of, and the ongoing difficulties currently facing the Social Security system, the feasibility of the Secretary of the Treasury accurately prescribing regulations for converting the aggregate Social Security taxes paid by an employee to an equivalent pension benefit would of necessity be highly arbitrary and most likely at the expense of the rank-and-file employees.

Having only been associated with the Stevens company for a limited time, it is still quite apparent to me that the hard working diligent rank-and-file employees have characterized and built this company to its current position as one of the most respected privately owned concessionaire restaurateur firms in the United States. It is from those ranks that the current executives of the firm arose and are still carrying on the tradition of safeguarding the interest of all the Stevens "Family" as we look to "serve the action world". As more and more companies, in highly competitive fields as our own, realize the importance of their overall benefit packages to attracting and keeping "key" employees (at whom the bill is directly aimed), I feel the justification for this type of bill and the consequences of its implementation to the already overly complex world of the private pension system has not been adequately researched, and the recommendation of the American Bar Association and several other speakers during the June 10, House Ways and Means Committee hearing to "not act too hastily" should be heeded.

To impose the penalties this bill would direct at "key employees of the private pension community runs counter to the mandate the American people delivered to this administration in electing Mr. Ronald Reagan as our President. Legislation of this type would penalize the private sector as a whole and not penalize the public sector. I find it ludicrous and "laughable" that the bill would even eliminate additional cost-of-living increases in the limits on benefits and contributions for private plans when similar restrictions are not now imposed on congressional, civil service or other government pension plans.

Speaking of "laughable" in the face of disparate and inadequate tax cuts and increasing federal deficits, there still exist individuals who "legally abuse" the private pension system. Have you heard the one about the doctor/lawyer who incorporated and opened a pension trust? It appears he deducted his pension contribution and obviously had to pay interest—so not only did he have the use of the money immediately, but since he is the trust, the interest he paid to himself was also deductible. This same doctor/lawyer then bought some property with the loan and rented it, and guess what? He depreciated the property and took a deduction for that loss. All these deductions and reductions to taxable income, when the federal government is projecting multibillion dollar budget deficits, and is seeking to generate revenues at the expense of the "whole" private pension community.

I do believe Mr. Rangel's intentions were honorable, and there are severe abuses and misuses of the private laws as they currently exist. Certain individuals (doctors/lawyers) and their "practices," excuse the pun, should be stopped. In addition, a little belt tightening would curtail those abuses and serve to generate billions in much needed federal revenue, not at the expense of the general pension community and eventually, the rank-and-file workers who still epitomize and characterize the heart of the free enterprise system through which this great nation still thrives. At the end of their working days they should still be able to maintain a reasonable standard of existence through an adequate pension "award" for years of conscientious and diligent work. Especially since it is becoming increasingly hard to save for retirement, home ownership and the resulting equity is becoming increasingly difficult, and it will be unwise to further overburden a Social Security system whose future is still questionable.

Sincerely,

VON HILTON CLARKE,
Employee Benefits Administrator.

TALMAR ASSOCIATES, INC.,
Indianapolis, Ind., June 15, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR SIR: This is a written statement for the printed record of the hearing on H.R. 6410, the Pension Equity Tax Act of 1982. As required, five copies of this statement are enclosed.

The statement is filed by: John F. White, Regional Representative, 6117 Allisonville Road, Indianapolis, Indiana (317) 257-1333.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

(1) The lowering of maximum benefit and contribution limits and elimination of the automatic cost-of-living escalator will have a severe adverse effect on lower-paid workers. Reduction of the maximum benefit if payment is made prior to age 65, in a defined benefit plan, will discourage early retirement and have an adverse effect on the unemployed or underemployed.

(2) Elimination of plan loans to key employees will have the effect of eliminating loan provisions altogether and will cause severe economic hardship to many American workers.

(3) The change in defined benefit plan integration to allow an offset only with respect to Social Security benefits paid for by the employer who maintains the plan should not apply to plan participants who have adequate service to receive full benefits.

(4) There is no rational basis for singling out employees in certain industries to receive reduced retirement benefits.

(5) We support the concept that non-discriminatory rules should apply in statutory fringe benefit programs.

(6) No new legislation is needed in the estate tax area.

It is my general opinion, and that of my firm, that this proposed legislation is an effort to completely undermine the private pension system at a time when our increasing aging population is in dire need of the means to be self-sufficient. Each year the ratio of active workers to those who are dependent on them for inter-generational monetary transfers gets smaller. Each year the inability of the public Social Security system to anticipate inflation becomes more obvious. This legislation would introduce the worst elements of the Social Security system into the private retirement system, would virtually negate much of the Employee Retirement Income Security Act of 1974, and would work its greatest hardship on lower-paid workers who can least afford reductions in retirement benefits. My specific objections and suggestions are outlined below:

1. H.R. 6410, SECTION 2

Lowering the maximum permissible benefits and contributions would have its most drastic effect on lower-paid workers. Plan formulas would be adopted (or revised) to provide the highest paid participants with the lower benefit or contribution and, in the process, benefits or contributions for lower-paid workers, who can least afford reduced pensions, would be cut. For example, if a company whose owner earns $300,000 per year were to establish a defined contribution plan under the present law, a contribution formula of 15 percent of compensation would provide the owner-participant with a near-maximum contribution of $45,000. If that same company were to establish a plan under the terms of the new bill, a contribution formula of 10 percent of compensation would provide the owner-participant with the maximum benefit and it is likely that the selected formula would not exceed that percentage. Thus, the contribution for a worker who earns $10,000 per year would be $1,000 annually rather than the $1,500 annual contribution which could be available under present law. There would be a similar result in a defined benefit plan. In virtually every instance where a reduced maximum would cause reductions in benefits or contributions for the highly-paid, there will be resultant reductions in benefits for lower-paid workers if the bill is enacted. The lower-paid workers will feel the effect of the reductions more severely than will the higher-paid workers, who will have other capital (more capital, in the case of owner-participants, because of savings in retirement plan contributions) available for retirement savings, if the bill is enacted.

The proposal to cut back the maximum benefit under a defined benefit plan if payment is made before age 65 (55 under present law) is contrary to public policy in that it discourages early retirement. This is, perhaps, the most damaging proposal in the entire bill. By requiring a cutback in the maximum benefit (in addition to the actuarial cutbacks already required under present law, in integrated plans) the terms of the bill would make it impossible, in many cases, for higher-paid workers to retire before age 65 at an income level even near to what they need to maintain their current lifestyles. The absolutely certain, and immediate, effect of enactment of this provision would be reduced employment at all levels as higher-paid workers must remain employed. Without question, minority workers would pay the entire cost of this provision as the older, higher-paid, traditionally white male executive is forced to remain on the job. Fewer opportunities for advancement at all levels would open up for the traditionally unemployed and underemployed minorities. At a time when unemployment is at near-depression levels, it is truly unthinkable to even propose legislation of this type.

Removal of automatic cost-of-living increases from the maximum benefit and contribution sections of the law would result, again, in lower contributions and benefits at all levels. This proposal is particularly bad because private sector plans would be saddled with the most pronounced weakness in the public sector Social Security system, which is the inability to cope with spiraling inflation.

2. H.R. 6410, SECTION 3

This bill would effectively eliminate loans to certain key employees and, in the process, to all employees. It is unlikely that many plans would contain any loan provisions if the company owners and officers were not entitled to receive them (without being taxed on the loan amounts). It seems inconceivable to prohibit workers from borrowing against what is, in many instances, their largest asset, without incurring tax liability. I find it incredible that the proposed effective date for this provision is May 19, 1982. This could literally cause financial ruin to plan participants throughout the nation, who are now borrowing money in accordance with the terms of the law as it is now written and who are totally unaware of this bill.

In this section the bill shows a total insensitivity to the needs of workers at all levels to use their savings to finance current emergency needs. This comes at a time when it is especially difficult to obtain commercial financing. Under present law, each participant loan must be reported to the government annually. If it is believed that there are abuses in the use of plan loan provisions, then I suggest stricter enforcement of the present law. The guidelines for loans to participants are clearly set forth in E.R.I.S.A. and a mechanism for monitoring loan activity has been established as a part of the annual reporting requirements. Surely, proper enforcement is a better solution to any participant loan problems than abolition of what is a most essential part of any savings system, for many American workers.

3. H.R. 6410, SECTION 4

This section appears to be contradictory to the rest of the bill in that reduced Social Security offsets will cause increased costs and, thus, increased tax deductions. More importantly, the proposed reduced offset should only apply with respect to plan participants who receive reduced pensions because of short service. In other words, the full present offset should be allowed with respect to any participant who has enough service with his or her present employer to receive a full benefit under that employer's plan.

4. H.R. 6410, SECTIONS 5 AND 6

Because recent legislation, already enacted, has eliminated the means for discriminatory abuse in the professional corporation retirement plan area, it is our belief that there is no rational basis for choosing the employees in certain industries and occupations to receive less favorable tax treatment than others. Also, this section makes no provision for protection of already accrued benefits.

5. H.R. 6410, SECTION 7

We generally support the principle of prohibiting discrimination with respect to statutory fringe benefits.

6. H.R. 6410, SECTION 8

Present law, generally, denies an estate tax exclusion to those who receive favorable income tax treatment with respect to death payouts from qualified plans. It is our belief that no further legislation is necessary in this area.

In summary, we believe that H.R. 6410, if enacted, would make a mockery of all efforts during the past decade to create retirement plan equity. The bill was poorly conceived and its precepts show total disregard for the rights and problems of American workers. The bill has little in the way of safeguards for already accrued rights and its enactment will cause billions of dollars of administrative expense to companies who can ill afford such costs. Beyond all of this, the enactment of this bill would certainly trigger a reduction in the number of workers who are guaranteed retirement safety, as plans are terminated or not implemented because of the provisions contained in the bill.

Sincerely,

JOHN F. WHITE.

Paul A. Tanker & Associates,
Pension Consultants & Actuaries,
June 16, 1982.

John J. Salmon,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: We would like to take this time to comment on the bill which was proposed by Congressman Charles B. Rangel of New York, H.R. 6410, "Pension Equity Tax Act of 1982". Although we were not able to come down to the hearing which was scheduled for June 8 1982 before the Ways and Means Committee, we would like to make written comments on the proposed bill. Paul A. Tanker & Associates is an actuarial and Pension consulting firm with clients in the Mid-Atlantic States area. We feel that it is necessary to comment on the Rangel Bill on their behalf.

As you will recall, in 1974 pension reform was instituted in the form of the Employee Retirement Income Security Act of 1974 (ERISA) which had a great impact on pension planning. Prior to the passage of ERISA there was no ceiling on the size of retirement benfift that could be paid by a plan to an individual. ERISA sought to carve out a maximum benefit that could be provided which in turn actually limits the contribution that could be made in a participants's behalf. Code Section 415 which was amended to conform with ERISA containes the maximum benefit and contribution limitation. The current 415 limitation for defined benefit plans is the lesser of 100 percent of the Participant's compensation of $136,425 (increased from the original $75,000 established in 1974). The current 415 limitation for defined contribution plans is the lesser of 25 percent of the Participant's compensation or $45,475 (increased from the original $25,000 established in 1974). The rationale behind the cost of living adjustments from the 1974 figure is to adjust for inflation so that when an individual actually receives his or her pension it is reflective of the benefit which was originally set up in his or her behalf by his or her employer. The first proposal of the Rangel Bill seeks to reduce the annual benefit limitation for defined benefit plans to the lesser of 100 percent of a Participant's compensation or $90,000 with no cost of living adjustment to the $90,000 figure. For defined contribution plans the Rangel Bill proposes to reduce the $45,475 to $30,000 with no cost of living adjustment to be made. The effective date of this provision applies to Plan years ending after December 31, 1983. In the case of the Participant in a defined benefit plan who is currently accruing a higher benefit than a benefit set forth in Rangel Bill, that Participant is entitled to that current accrued benefit if it is higher than the $90,000 amount. Any individual who becomes a Participant in a Plan after January 1, 1984 is subject to the $90,000 amount.

The diminution of the beneift limitation under Code Section 415 is aimed at reducing the amount of tax free accumulation which is available under corporate pension plans to currently create more federal revenue. What Congressman Rangel failed to note is that a decrease in the 415 limitations will not increase federal revenues in the long run, since the monies which are held in a Trust Fund, although they have a current tax deferred status, are eventually taxed upon an individual's termination of employment or retirement. If the object is to limit deductions in corporate pension plans than the pertinent Code Sections changed would be Code Section 404 which deals with deductible contributions to qualified Pension Plans. The overall effect of reducing the 415 limitations to $90,000 and $30,000 will cause an employer who sets up a benefit program under a pension plan to cause the plan design to be readjusted by reducing pension benefits across the board, affecting all classes of employees. Since employees in the lower compensation range would be affected by the reduced pension benefit those employees would be faced with lower available income upon retirement due to plan design adjustments.

The Rangel Bill also proposes to reduce the 1.4 rule to the 1.0 rule in a case where an employer maintains both a defined benefit and a defined contribution plan. It has been our experience in the design of benefit plans where the 1.4 rule must be utilized, that the .4 part of the 1.4 rule is actually the part that provides lower paid employees with the most benefits. The proposals also discourages employers from setting up multiple plans. The use of multiple plans enables an employer to set up a benefit program which will satisfy the needs of its older employees who benefit more from a defined benefit plan and its younger employees who benefit more from a defined contribution plan. The concept of utilizing 1.0 will cause any employer who maintains two plans to terminate the subordinate defined contribution plan.

The Rangel bill alters the concept of a Plan benefit which is offset by Social Security which rules are currently provided under Revenue Ruling 71-446. Under this ruling an employee's annual pension benefit may be reduced by up to 83⅓ percent of the Primary Insurance Amount to which an employee is entitled under Social Security. The Rangel Bill alters its concept by providing that an employer may reduce pension plan benefits by no more than the employee's Social Security benefits directly attributable to the employer provided contributions to the Social Security system for the employee. Because Rangel Bill defines allowable integration limits in terms of Social Security benefits actually paid in by a particular employer, and not the wage base, all integrated plans would require extensive redesign in order to comply with the provisions of the bill. We do not believe that the manner in which Congressman Rangel proposes to change Social Security integration in pension plans achieves pension equity. Furthermore the cost of redesign work will be prohibitive since it has been our experience that the majority of the defined benefit pension plans which we administer are integrated in some manner with Social Security benefits under Revenue Ruling 71-446. Additionally, the Bill is also inconsistent since it provides that these new Social Security integration rules in defined benefit pension plans only apply with respect to employees who become plan participants after December 31, 1983. Thus you have the situation of participants in any given defined benefit plan being treated differently one from the other and this certainly is an inconsistent position to be taking with respect to pension planning. Moreover, new participants after December 31, 1983 will benefit more from the plan than those who became participants prior to that date. The change in the Social Security integration rules will also cause major revisions in benefit planning since an employer who wants to provide an employee with certain benefits which are in addition to the Social Security benefits which the employer provides for an employee, the employer is obligated to redesign an overall benefit formula for the plan participants by estimating the time an employee remains in employment.

Another proposal in the Rangel Bill would prohibit loans to key employees where key employees would constitute employees who are officers, more than 5 percent shareholders or among the highest paid 15 percent of the employer's employees. In order for a pension plan to continue to maintain its qualified status where loans are permitted, the loans must be adequately secured, repayment schedules must be made and the loan must bear a reasonable rate of interest. With those protections, it is our position that loans should be permitted in all circumstances under pension plans with no restrictions as to who makes the loan so long as these loans do not discriminate in favor of employees who are officers, shareholders, or highly compensated. This proposal is attempting to bootstrap the Keogh plan rules to the corporate plan rules.

The Rangel Bill proposes to subject personal service Corporations to the H.R. 10 rules. A personal service Corporation would constitute any Corporation the principal function of which is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics, or consulting. The H.R. 10 rules are much more restrictive with lower deductions. The intent of this proposal extends far beyond the scope of increasing federal revenues. The intent is to discourage the formation of professional service corporations by sole practitioners and small paratnerships. It also tends the modern entrepreneur by treating him differently than his similarly compensated counterparts in large corporations.

In conclusion, we feel that the Rangel Bill does not accomplish its goal of creating more federal revenue nor does it accomplish its goal of providing more equity in pensions plans. It will discourage the growth of new plans for small pension plans. It will discourage the growth of new plans for small companies, and will also cause, if any of the major import of the bill is passed, many plans to terminate only because since the passage of ERISA so many costly changes have had to be made. Certainly the redesign of any integrated plan will constitute undue burden and the administration costs will be higher since the bill also treats one group of employees differently from the other due to the effective date of the Rangel Bill. The ultimate effect will be that the rank and file employee will not have the compensation that needs to be replaced for retirement purposes. This in turn will result in new added political pressures, to increase Social Security benefits from a system whch is already overloaded and questionably able to meet its goal.

We feel that there is a need for legislation which undertakes to create additional tax incentives to create pension plans since the Social Security system fails to provide on its own an adequate standard of living at retirement. There are many other means besides the proposals in the Rangel Bill which can be instituted which will provide equity to all participants who are accruing benefits in private pension plans. Unfortunately, the Rangel Bill only serves to create more expense and fails to accomplish the goals sought in addition to the monumental regulations which would be required. We respectfully request that you consider our comments in making a decision on the Pension Equity Tax Act of 1982.

Sincerely yours,

SUZANNE MCCARTHY, Esq.,
Staff Attorney.

GRAND RAPIDS, MICH., *June 16, 1982.*

JOHN SALMON, Esq.,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON. I am writing to express my views on HR 6410—the "Pension Equity Tax Bill of 1982". I am an attorney in private practice with a law firm in Grand Rapids, Michigan and spend more than half of my time on employee benefit plans. Since the time of the original news release concerning HR 6410, I have received letters from a number of other pension lawyers and actuarial firms urging me to write letters to Congressmen concerning the bill. Hence, this letter.

I think HR 6410 addresses some of the major inequities in the law governing and abuses of the private pension plan system. I am not expressing support for the entire bill, but urge the committee to give serious consideration to certain provisions.

The bill addresses the most glaring inequity in the law governing the private pension system, that is, the disparity in treatment of partnerships or sole proprietorships as opposed to corporations. The bill proposes to increase the maximum contribution level for "self-employed" plans (HR 10 Plans) to $30,000 and simultaneously reduce maximum contributions to corporate defined contribution plans to the same level. I am clearly in favor of placing HR 10 plans on a par with corporate plans. I am not expressing an opinion as to whether $30,000 is the appropriate contribution level, but believe that most of our clients could live with a $30,000 limit on contributions provided a cost of living adjustment were added to the bill.

The historical disparity between HR 10 plans and corporate plans has caused a great many businesses to incorporate when the non-tax considerations do not favor incorporation. Professional practices are incorporated because of the substantially more generous corporate retirement programs. Many law firms refuse to incorporate because of a historical bias against practicing in the corporate form and, as a result, there are now a number of law firm partnerships with professional corporations as partners.

The tax advantages of incorporation have caused professional people to place an artificial corporate barrier between themselves and their clients. It has also caused professionals to spend a great deal of money on legal fees to maintain the artificial barrier. Professional corporations must maintain corporate minutes, employment contracts and various other documents to insure that their corporate status will be recognized and tax benefits obtained.

In my opinion, the time and effort that is spent in establishing and maintaining corporations solely for tax reasons is terribly unproductive. If Congress would eliminate the disparity between retirement plans for partnerships and those for corporations, it would do a great service to business and professional people. Businessmen and professionals could operate in the most appropriate form without considering the substantial tax advantages of one form of organization over another.

HR 6410 also addresses a couple of areas of abuse in the private retirement plan system. The abuses are the funding of the pension plans for retirement prior to age 65 and loans to key employees.

Pension plans provide a very attractive tax shelter for highly compensated persons when the plans are funded for retirement before age 65 and with unreasonably conservative actuarial assumptions. As soon as the IRS announced it would permit funding of pension plans for retirement as early as age 55, the technique began to be employed to provide a substantial tax shelter for the principals of closely held and professional corporations. The use of age 55 as the normal retirement age and conservative actuarial assumptions enable corporate pension plans to obtain tax-shelter for funds that are far in excess of the amounts required to pay pension benefits.

The second area of abuse addressed by the bill is the use of loans from corporate retirement plans. Once again, the bill proposes to eliminate or at least reduce the disparity between HR 10 and corporate plans with respect to participant loans. I view these portions of the bill as positive reforms of the private pension plan system.

There are a couple of provisions in HR 6410 that I do not think are required to correct any abuses in the system. The bill proposes to revise the current rules for integrating private plans with social security. I think the current rules on social security integration are fair and workable. Moreover, the availability of the social security integration serves as a strong inducement for employers to establish retirement plans covering all of their employees. Granted, the principals get greater benefits from the retirement plans than lower paid employees, but the plans benefit all employees in some measure and are certainly preferable to no retirement plan.

The second provision of the bill that I find unnecessary is the application of the HR 10 plan rules concerning minimum participation, vesting and distribution limits to professional corporations. Again, I have never understood why partnerships were treated so poorly under the retirement plan laws. I have never understood why the same rules cannot apply to corporations and partnerships with respect to participation, vesting distributions and integration with social security. Therefore, I cannot understand why the HR 10 restrictions should be extended to plans for professional corporations, but not business corporations.

I think the Committee should consider removing the HR 10 restrictions altogether rather than imposing them on professional corporations. These restrictions do not apply to business corporations with only a few employees and it is difficult for me to understand the justification for applying them to partnerships and professional corporations. This is another area in which the disparity should be eliminated rather than simply expanding the restrictions to cover more, but not all, employers.

Some of my colleagues in the field of employee benefit plans are predicting dire consequences for the private pension plan system if HR 6410 is passed. I do not agree. However, I do think there are aspects of the bill that have less to recommend than others. I think the bill should be given serious consideration with respect to the inequities and abuses of the present system. I do not think it should be adopted in its entirety. Thank you for considering my views.

Very truly yours,

LARRY J. TITLEY.

SUBMITTED BY TOWERS, PERRIN, FORSTER & CROSBY

[From TPF&C News]

RANGEL BILL WOULD ADVERSELY AFFECT MOST EMPLOYEE PENSIONS

NEW YORK.—H.R. 6410, the Pension Equity Tax Act of 1982, would adversely affect employees at all pay levels. It will not, as it purports to do, provide incentives for including the broadest possible class of employees in pension and fringe benefit plans, according to Philip M. Alden, Jr., Vice President, Towers, Perrin, Forster & Crosby, international management consultants.

Moreover, by sharply lowering present limits on benefits from and contributions to private pension plans, the bill, introduced by Rep. Charles Rangel (D-N.Y.), will discourage establishment of new private retirement plans and thwart the liberalization of existing plans. "It is especially ironic," says Alden, "that at the very time when cutbacks in Social Security seem inevitable, the Congress might simultaneously seek to diminish the vitality of the private pension system. Old age security, it would seem, is slated to be yet another casualty of the drive for revenue enhancement."

In the long term, the bill would stymie new capital formation and increase administrative expenses for sponsors of private benefit plans, thus reducing profits and corporate income tax revenue.

Specifically the bill would:

Reduce the maximum pension payable under qualified plans and eliminate the indexing of these maximums for future cost-of-living increases. Given even moderate inflation rates, these limits could, in the future, affect the majority of the work force.

Reduce the opportunities for employees to be covered by both a pension plan and a supplemental profit-sharing or thrift plan. The supplemental plan is frequently looked upon as a way of helping those on fixed pensions cope with cost-of-living increases after retirement.

Reduce the ability to integrate private pension plans effectively with Social Security. As a result, many companies, faced with the higher pension costs, might find it necessary to reduce benefits.

Effectively prohibit "key employees" from borrowing money from a qualified plan. Under the bill, key employees include not only officers, those with substantial ownership interest and the highly paid but also any employee who participates in cash or deferred compensation arrangements (CODAs) under the new—and popular—Section 401(k) rules.

A hearing on the bill will be held by the House Ways and Means Committee on Tuesday, June 8, with the apparent goal of quick passage as part of the budget reconciliation process. "Such comprehensive and far-reaching legislation deserves far more careful and deliberate review than it is likely to get at this time," says Alden.

Attached is a critical analysis of H.R. 6410, prepared by Towers, Perrin, Forster & Crosby.

Towers, Perrin, Forster & Crosby specializes in human resource, actuarial and selected general management consulting services. The firm has offices in 32 cities worldwide—18 in the U.S., four in Canada, four in Europe, three in Australia, two in Latin America and one in the Far East.

H.R. 6410—THE PENSION EQUITY TAX ACT

Attached is a critical analysis of H.R. 6410, the Rangel bill, now awaiting congressional action.

This bill would amend the Internal Revenue Code to impose harsher limits and rigorous new requirements on pension, profit-sharing, thrift and other employer-sponsored benefit plans. Specifically, it would:

Reduce sharply the maximum contributions to and benefits from most qualified retirement plans.

Eliminate the indexing of those maximums for future cost-of-living increases.

Require amendment of all plans integrated with Social Security, and a complete restructuring of many.

Have the effect of prohibiting loans under qualified plans to "key employees" (as defined in the bill) and to all employees covered by a Sec. 401(k) cash-or-deferred arrangement.

Mandate immediate full vesting and broader eligibility under all H.R. 10 (Keogh) plans.

Impose H.R. 10 limits on all shareholders of companies in selected segments of the service industry.

Extend nondiscrimination requirements to group term life insurance and insured medical plans, and apparently to disability income plans as well.

No bill in the eight years since the passage of ERISA has had more adverse implications for employees and benefit plan sponsors than this one. Prompt, incisive action is needed to forestall its adoption.

H.R. 6410—The Pension Equity Tax Act of 1982—A Critical Analysis

I. INTRODUCTION

Background

H.R. 6410 was introduced in the Congress on May 19, 1982, by Rep. Charles Rangel (D-NY). Officially named The Pension Equity Tax Act of 1982, the Rangel bill willl have a public hearing before the House Ways and Means Committee on June 8. The bill's future is uncertain, but the implications it bears for pensions and other private employee benefit plans are already becoming clear.

Purpose of this critique

TPF&C has prepared the following critique of H.R. 6410 to inform its clients and other friends of the bill's key features.

In common with tax bills, this one is rife with obscure cross-references, ambiguities and apparent errors. It leaves a number of critical details to be resolved "under regulations prescribed by the Secretary [of the Treasury]." Thus, the full impact of H.R. 6410 would not be known until those regulations were issued. Enough can be gleaned from the text of the bill, however, to discern the probable effect of the law on benefit plan design and operation.

We urge you to: Review this analysis carefully; consider what effects the bill would have on your company and its employees, both now and in the future; and make known to your Congressional representatives and your employees what you perceive those effects to be.

TPF&C's concerns

The Rangel bill appears to have been conceived in haste and positioned for quick passage in the confusion surrounding the current budget crisis in Washington. In TPF&C's judgment, such comprehensive and far-reaching legislation deserves far more careful and deliberate review than it is likely to get at this time.

The bill's sponsor claims to have two objectives: first, to "provide greater tax incentives for the comprehensive inclusion of the broadest possible class of employees in tax-subsidized pension and statutory fringe benefit plans," and second, "to reduce the excessively high tax limits on tax-free accumulations under corporate pension plans." We submit that the first of these goals will be thwarted, not aided, by the bill and that the second is a classic example of legislative overkill. In fact, the adverse effect of the bill would be felt by employees at all pay levels.

The most obvious consequence of enacting H.R. 6410 is apt to be a harp decline in the formation of new private retirement plans. Moreover, employers sponsoring existing plans would have little or no incentive to liberalize them. It is especially ironic that at the very time when cutbacks in Social Security seem inevitable, the Congress might simultaneously seek to diminish the vitality of the private pension system. Old age security, it would seem, is slated to be yet another casualty of the drive for "revenue enhancement."

Secondary effects of the Rangel bill include a reduction in new capital formation and a further increase in burdensome federal regulation. Hundreds of thousands of employee benefit plans would require extensive revision, leading to costly (and nonproductive) expenditures of time and money. This, together with an enlarged administrative burden for all future years, would serve only to reduce business profits and corporate income tax revenue.

For the record

Companies that are able to furnish the members of the Ways and Means Committee specific examples of the impact of the Rangel bill on their employees can strongly influence the Committee's actions. TPF&C consultants can help your company prepare written testimony for the record. These comments will be accepted by the Committee as late as Friday, June 18, 1982.

II. LOWER CONTRIBUTION AND BENEFIT LIMITS UNDER QUALIFIED PLANS

Reduced retirement benefits

If enacted into law, the Rangel bill would reduce the maximum pension payable under a qualified plan from $136,425 for 1982) to $90,000. Annual additions to a defined contribution plan would be limited to $30,000 instead of the current $45,475. For employees covered by both a defined benefit and defined contribution plan—for example, a pension plan and a thrift plan—the new reduced dollar limits would be effectively cut in half. That's because the extent to which each plan's dollar limit is used could not, when added together, total more than 100 percent of the single plan limit—down from 140 percent under current law.

Pension limits would be further reduced for early retirement, and the dollar amounts would no longer be adjusted for inflation. Finally, medical benefits for retirees and their dependents would count against the dollar limit applicable to defined benefit pension plans.

Who will be affected by the cutbacks?

Many, many more employees would be affected by the limitations than ever before. When the Congress first imposed limits on corporate retirement benefits, in ERISA, the amounts were set at $75,000 (or 100 percent of pay, if less) for defined benefit and $25,000 (or 25 percent of pay) for defined contribution plans. The dollar limits were subject to adjustment for inflation, and eight years later stand at $136,425 and $45,475, respectively. The new limits would be a sharp rollback (34 percent reduction), but that's only the tip of the iceberg. The present defined benefit limits apply without adjustment for early retirement at ages as low as 55. Rangel would scale back the limits for any retirement below 65. This means that the maximum pension limit could be about $72,000 for an age 62 retirement, $45,000 at age 55, and perhaps $30,000 for retirement at age 50. The precise figures would depend on the actuarial assumptions imposed by tax regulations.

The combined limits

The really dramatic cutback under Rangel would come about subtly through a change in the complex "1.4" rule for employees in two types of plans (e.g., pension and thrift). The current rule goes like this: the benefits of each plan are measured against the legal maximums, and a fraction for each plan is determined by dividing the plan benefit by this legal maximum. When the two fractions are added together, the result cannot exceed 1.4, i.e., 140 percent of the single plan limit.

H.R. 6410 would permit this "combination" limit to be only 1.0. Thus a participant with an accrued pension of $45,000 payable at age 65 could receive only $15,000 annual profit-sharing plan addition. Each plan would provide one-half of its statutory limit, and the combination could not exceed 1.0. Even worse, if the employee were entitled to $45,000 starting at age 55, he would be at the maximum pension level and could have *no* profit-sharing or thrift contribution.

It should also be noted that the computation of the defined contribution fraction (under a two-plan scenario) would be substantially altered from current law. The rule today is that this fraction is the sum of all "annual additions" divided by the sum of the maximum limits for all years of an employee's service. (The "annual addition" is the total of all employer contributions, plus reallocated forfeitures, and employee contributions over 6 percent of ½ of employee contributions, if that is less.) By constructing a fraction from the running totals of the additions and limits, an employee can thereby "bank" unused prior limitations.

The Rangel bill would define the fraction as the greater of the historical average or the current year's fraction. Consider the plight of the employee who, after years of working for a marginally profitable company, finally received a single profit-sharing contribution of $30,000 in his retirement year. Because his defined contribution fraction was 1.0, his entire pension would be forfeited!

For employees in salary reduction cash/deferred (401(k)) profit-sharing plans, the potential problem is, if possible, even worse. That's because the amount of salary reduction is considered an employer contribution, and the compensation base (for purposes of these limits) drops by the amount of the salary reduction. A $50,000 a year employee who agreed to a $10,000 salary reduction would have used up his full limit for all plans ($10,000/$40,000 equals 25 percent, and 25 percent divided by the 25 percent limit equals 1.0).

We noted earlier than an employee age 55 with an accrued early pension of $45,000 could have no annual additions to a defined contribution plan because his pension was at the maximum. We also observed that an employee with a one-time $30,000 annual addition (made up of, say, salary reduction and employer contributions) could have no qualified pension if he retired that year. Now let's look at someone covered by a 30-and-out pension plan who received a 15 percent of pay profit-sharing allocation.

This employee would have a 0.6 defined contribution fraction because the limits were the lesser of $30,000 or 25 percent of pay, and 15 percent divided by 25 percent equals 0.6. Accordingly, he could have a pension of only 4/10 of the defined benefit limit. Assuming he were eligible for a full pension at age 50, this would mean that his maximum pension (after the profit-sharing allocation) could be only about $12,000—i.e., 4/10 times $90,000 times a two-thirds actuarial reduction from age 65. And this $12,000 would be further reduced by the value of any company-provided medical benefits for him and his dependents.

Things could get worse

Under H.R. 6410, the dollar limits would contain no cost-of-living adjustments. For that reason, along with many others, the bill is not what its sponsor intended; it would not have an adverse effect only on executive-level employees.

For example, take a representative pension plan that provided about 45 percent of final pay to career employees. Currently, a retiring employee with earnings of $200,000 receives a $90,000 pension—the exact limit under Rangel. Assuming the plan never changed, anyone at $200,000 in the future would also bump into this limit. How many employees will ever reach such a pay level?

The answer is, quite a few. If future inflation rates average 9 percent, and the company grants annual merit and promotional increases of only 4 percent, the combination of pay raises (13 percent a year) will subject all of the employees described in this table to the Rangel maximum:

Current age:	*Current pay*
59 or less	[1]$100,000
53 or less	[1]50,000
49 or less	[1]30,000
46 or less	[1]20,000
40 or less	[1]10,000

[1] Or more.

The problem would be even more acute for employees hoping to retire early; the foregoing numbers assume that retirement takes place at age 65 and the full $90,000 limit is available.

The effects of inflation on employees covered by two plans subject to the proposed 1.0 limit are also ominous. Suppose a company had a final pay pension plan providing benefits of 1¼ percent per year of service. It also had a modest profit-sharing plan, under which contributions average 5 percent of pay each year. What would be the results of the combined plan limits? Assume employees receive average total pay increases of 13 percent a year (9 percent inflation) and, as an alternative example, increases averaging only 7 percent (3 percent inflation).

Present age	Employee service	Present annual earnings at or above which employee will ultimately be subject to plan limits [1]	
		9 percent inflation	3 percent inflation
25	0	$1,542	$11,727
35	0	6,978	30,758
35	10	5,233	23,068
45	0	35,530	90,757
45	10	23,687	60,505
45	20	17,765	45,379
55	10	120,608	178,534
55	20	80,406	119,022
55	30	60,304	89,267

[1] Ignores effect of "grandfather" rules described below.

The table illustrates vividly how serious is the future lot of young employees under the Rangel bill, even under inflation rates far less than we have experienced in recent years.

The future of private pensions

The consequences of these harsh and irrational qualified plan limits would be devastating to the private retirement system. And they come at precisely the time when the system is being called upon to increase its role in meeting the overall retirement income needs of American citizens.

Under Rangel, the use of non-qualified "excess" benefit plans would be dramatically increased—in time, perhaps, overshadowing that of qualified plans. Because non-qualified plans can be discriminatory, and generally are not funded, there could be a substantial loss of retirement income for the lower paid, as well as a drying-up of new capital in the country's organized financial markets. Qualified plan adoption and design could also be set back, because the decision-makers in a company would receive most of their retirement benefits from a non-qualified "excess" plan and might well be disinclined to maintain a liberal qualified plan largely for rank-and-file employees.

A special victim of this legislation might be the two-plan employee benefit package (usually pension and thrift), an arrangement under which each plan compensates for the inadequacies of the other. The 1.0 rule will force many employees to choose benefits under only one plan—or employers to choose for them.

Accordingly, most employers might eventually *offer* only one plan, thus greatly weakening the total retirement income stream from the private sector.

Effective dates

If adopted, the rules described in this section would be effective immediately for new plans; existing plans would have to comply for plan years ending after 1983. Pre-1984 participants having accrued defined benefits greater than $90,000 would be grandfathered.

III. LOANS UNDER QUALIFIED PLANS TREATED AS DISTRIBUTIONS

H.R. 6410 would require a "key employee" to include in income (as if it were a plan distribution) any amount borrowed from a qualified plan. The same rule would apply where a key employee pledged an interest in a plan as security for a loan.

"Key employees" are defined by the bill as including officers, employees with greater than 5% ownership interestes in the employer and anyone else among the 15% highest-paid employees.

"Key employees" would also include any employees who elect to defer amounts under CODAs (Sec. 401(k) arrangements) or who are covered by tax-sheltered annuities (Sec. 403(b) annuities), if they borrow or pledge the amount they elected to defer.

Similar restrictions on loans already apply to certain self-employed persons under H.R. 10 (Keogh) plans and to holders of individual retirement accounts or annuities (IRAs).

Current law

Under current law, assets of qualified plans may be lent to participants if certain conditions are met. The loan must bear a reasonable rate of interest, be adequately secured, provide a reasonable repayment schedule and be available on a nondiscriminatory basis. Self-employed plans (H.R 10 plans) may not lend to an "owner-employee"' (a sole proprietor or a 10 percent-plus partner). A loan to or a pledge of a plan interest by any self-employed person, whether or not an owner-employee, is treated as a plan distribtuion and included in that person's income.

Implications of the proposed new rules

The changes made by the Rangel bill would impose new restrictions on loans from qualified plans even though there is no record of demonstrated abuse in this area. These provisions would become effective retroactively to May 19, 1982.

The retroactive nature of this section of the bill is troublesome. Any key employee who unwittingly borrowed from a plan or assigned or pledged his or her interest in a plan after May 19, 1982 would be taxed on the amount in question, even though the bill has not yet been enacted into law. And any renegotiation, extension, renewal or revision of a prior loan would be treated as a new one, with the same effect.

For employers contemplating adoption of a CODA under Sec. 401(k), the effective prohibition against loans of deferred amounts may cause a reassessment of that action. Where a CODA has already been adopted and permits loans, changes would of course be required. Some employers may find that elimination of a loan provision may remove incentives for employee participation to such an extent that the CODA will fail the mathematical tests of Sec. 401(k).

IV. INTEGRATION OF PRIVATE PLANS WITH SOCIAL SECURITY

Under long established tax qualification rules, a pension plan must not discriminate in favor of high paid employees. Although the general rule is that neither contributions nor benefits may be greater for that group (as a percentage of pay) than for lower paid employees, the law allows an employer to include as an "employer benefit" the portion of each employee's Social Security benefits provided by employer taxes. Rules for determining the employer-provided Social Security benefit are set forth by the Internal Revenue Service.

Changes introduced by the bill

The Rangel bill would change the method of determining the amount of Social Security benefits deemed provided by employers. And, except for a special safe-harbor provision, it defines permissible integration in a way that appears to rule out defined benefit formulas using "additive integration," leaving "offset" type formulas as the only acceptable approach. The integration allowance for defined contribution plans would be reduced from the present 7 percent of Social Security covered wages to the actual employer OASDI contribution rate (currently 5.4 percent).

A review of present rules

Present integration rules assume that employer FICA taxes provide a Social Security pension benefit equal to 83⅓ percent of the employee's Primary Insurance Amount (PIA). Therefore, an offset type plan providing a benefit in the form of a single life annuity commencing at age 65 may reduce (i.e., offset) its formula benefit by 83⅓ percent of the PIA. IRS rules provide for equivalencies of this basic 83⅓ percent of PIA for use with other types of pension plan formulas. These can be summarized as follows:

1. Excess Final Average Pay Plans.—Plans that base benefits on final average earnings in excess of the average of maximum Social Security wages may provide up to 37½ percent of such "excess pay." If such a plan gives credit for each year of service separately, then the maximum allowance is 1 percent of excess final average earnings times years of service.

2. Career Pay Plans.—A plan that bases benefits on actual earnings during each year of employment, rather than on final average earnings, is limited to a benefit of 1.4 percent of earnings in excess of each year's Social Security wage base.

3. Defined Contribution Plans.—Plans that fix contributions rather than benefits may provide a contribution no greater than 7 percent of each year's earnings in excess of the Social Security wage base.

4. Step-Rate Plans.—The limits described in the preceding paragraphs apply only to the "integrated" portion of the benefit. Plans may always provide an underlying non-integrated benefit, which is ignored in testing for integration. For example, the 7 percent defined contribution plan limit can be used by providing a contribution of 0 percent on earnings up to the Social Security wage base and 7 percent on earnings in excess of that amount. Or, it can provide a contribution based on earnings up to the wage base of X percent and as much as (X+7) percent on earnings above that amount. Because the difference between the two contribution rates does not exceed 7 percent, the integration rules are satisfied. Similarly, a career pay defined benefit plan can provide a benefit of 1 percent of pay up to the wage base and 2.4 percent of excess pay for each year of service. The differential of 1.4 percent satisfies the limit of 1.4 percent stated in paragraph 2 above.

The IRS derived the equivalencies described above by converting the basic 83⅓ percent offset amount to other forms, using characteristics of average employees. The same equivalencies are used for all employees regardless of differences in their employment histories.

Summary of the changes

The integration rules introduced by Rangel would discard these average equivalencies. The basic offset integration allowance of 83⅓ percent of PIA would be replaced with an amount of Social Security benefit deemed provided by the actual taxes paid by the employer for old age, survivors and disability insurance (OASDI) on behalf of each employee. Employer OASDI taxes for each employee would be accumulated with interest to age 65 and then converted to an annuity equivalent, using interest rates and conversion tables that the IRS would develop. This annuity would then be the maximum offset amount permitted.

The bill provides a safe harbor for defined benefit plans. Under that rule, a plan would be deemed properly integrated if it provided benefits at any rate on earnings up to $30,000, twice that rate on earnings between $30,000 and $60,000 and at the same rate applicable to the first $30,000 of earnings on earnings in excess of $60,000. This safe harbor apparently could be used only for career pay type plans—i.e., one that bases benefits on actual earnings each year rather than on final average earnings. Moreover, the bill allows the safe harbor to be used by companies having both defined benefit and defined contribution plans only if the defined contribution plan is non-integrated.

Impact of the new rules on defined contribution plans

The employer OASDI tax rates are set by current law at 5.4 percent for 1983 and 1984, 5.7 percent from 1985 through 1989 and 6.2 percent for 1990 and later. Plans that currently allow a contribution differential greater than 5.4 percent on pay under and over the wage base, respectively, would have to be amended. Employers would have three basic alternatives: increase the contribution percentage on earnings below the wage base, decrease the percentage on earnings over the wage base, or simultaneously increase the contribution percentage on earnings below the wage base and decrease it on earnings over that amount. Only the thrid of these alternatives would permit plan costs to remain unchanged, but benefits would be skewed more to the lower paid than before.

Impact of the new rules on defined benefit plans

The effect of the new integration approach is much greater on defined benefit plans than on defined contribution ones. Because the problems are different, we deal first with offset-integrated plans and then with plans using additive integration, i.e., step-rate and excess plans.

Offset plans

Under the Rangel bill, the maximum Social Security offset for any employee would be the annuity equivalent (based on IRS conversion rates yet to be determined) of the OASDI taxes paid on his or her behalf by the employer sponsoring the pension plan. Clearly, offset plans could continue. However, the allowable offsets in many cases are likely to be lower than the 83⅓ percent of PIA allowed under current law, or even the 50 percent of PIA more typically found. Allowable offsets will be much lower for short service employees in plans that do not vary the amount of offset according to years of service.

TPF&C analyses (not reproduced here) indicate that allowable offsets might be slightly higher under the new law only for very young employees with pay at or near the maximum wage base—not a common occurrence.

Lower permissible offsets mean, of course, higher pensions—and higher employer costs unless benefit formulas are scaled down.

Calculations of allowable offsets would be simpler in some respects than under current law and more complex in others. Consider a plan under which the offset is presently 1.5 percent of PIA times years of service. That formula could be left intact but made subject to the new limits. For example, the employer would have to demonstrate that the nominal offset for every employee leaving after ten years' service (15 percent of PIA) was not greater than the age 65 annuity value of the employee's prior ten years' OASDI taxes paid by the company. The annuity value, in turn, would vary among all ten-year-service employees according to their ages even if the OASDI taxes happened to be identical. Alternatively, of course, the plan could be amended to express the offset in annuity value terms directly, abandoning the prior 1.5 percent formula.

Other integrated defined benefit plans

TPF&C believes it would not be practical to maintain a plan using additive integration under the proposed rules. This is best shown by using examples:

1. A career pay plan presently provides a pension accrual of 1 percent of employee earnings up to the Social Security wage base and 2.4 percent of excess pay for each year of plan membership. This may be thought of as a non-integrated benefit equal to 1 percent of all pay and an integrated piece equal to 1.4 percent of earnings over the wage base.

Two employees, A and B, have the same earnings and receive identical accruals. For example, if their pay is $42,400, the integrated benefit for a given year is 1.4 percent of $10,000 ($42,400 less the current $32,400 wage base), or $140. Now consider what happens under the proposed rules.

Both employees are limited to an integrated benefit "purchasable" by a contribution of 5.4 percent of $10,000. For Employee A, who is 30 years old, this equals about $298 (based on $540 plus 5 percent interest for 35 years and divided by 10 to get an annuity equivalent). Employee B, age 64, would, by contrast, receive an integrated benefit accrual for that same year of only $57. Explaining to employees—especially older ones—why their benefit accruals vary by age rather than pay would prove a challenging effort. Conceivably, such a plan would even violate ADEA, the Age Discrimination in Employment Act.

2. A similar problem would arise for step-rate integrated plans basing benefits on final average pay. Consider a plan that provides a benefit of 1 percent of final five-year average pay up to the Covered Compensation amount and 1.5 percent of such pay in excess of that amount, all multiplied by years of service. (Covered Compensation is the average Social Security wage an employee would have had if he earned maximum Social Security wages in each year of his career.) Even though benefits are now determined for Employees A and B at the same age—say 65—the "excess" or integrated piece, 0.5 percent, could no longer reflect a fixed Covered Compensation amount. It would instead have to reflect actual employer OASDI taxes paid for each employee.

Even though A and B might have identical final five-year average earnings and length of service, they are almost certain to have had different pay histories prior to the final five years. Thus, their OASDI tax histories would be different. The adjustment to their pensions for employer-provided Social Security benefits could not be the same and still meet the requirements of the Rangel bill.

Grandfathering

The bill leaves intact for many employees the present integration rules applicable to defined benefit plans. The new rules would have to apply only to employees who become participants in existing plans on or after January 1, 1984. In all other cases, the new rules apply to plan years ending after 1983.

Many companies will find it untenable, however, to have different benefits for former and new participants. Therefore, the need to amend plans will extend far beyond simply imposing the new requirements on new participants. Additively integrated plans, in particular, would have to undergo a complete transformation; it would be suicidal in an employee relations sense to maintain additive integration for current employees and impose offsets on newly hired people.

The safe harbor rule

The bill's safe-harbor formula provides little solace or utility. First of all, it could be used only if a career pay structure were adopted. Career pay plans have the disadvantage of exposing participants to a loss of "real benefits" in periods of pre-retirement inflation—a loss that is avoided under final pay related benefit plans.

The safe-harbor formula could be used initially to sustain benefits for the higher paid by providing relatively high percentage amounts. For example, a plan could offer an annual accrual of 2 percent of pay up to $30,000, 4 percent of the next

$30,000 and 2 percent of pay over $60,000. This would be reasonably attractive if there were few employees in the under-$30,000 group. However, with continued inflation, a large proportion of "low paid" employees would soon have earnings in the $30,000 to $60,000 range. A safe-harbor type plan could become quite expensive for this reason, and is likely to have little appeal to most plan sponsors.

V. NEW RULES GOVERNING H.R. 10 (KEOGH) PLANS FOR SELF-EMPLOYED

The Rangel bill would increase the amount deductible under H.R. 10 plans by self-employed individuals to 15 percent of compensation or $30,000, whichever was less. As a "conforming change," the deductible limits applicable to contributions to simplified employee pensions (SEPs) would also increase. That is the good news; the rest is not so good. The bill would also impose some of the restrictions applicable to owner-employee Keogh plans on all plans covering self-employed individuals.

What the changes are all about

Current law makes a distinction between self-employed plans covering one or more "owner-employees" (i.e., persons owning more than 10 percent of a business) and plans covering self-employed individuals where there are no "owner-employees." Plans that cover owner-employees are subject to a number of special restrictions, including rules regarding the type of plan trustee, the time and amount of plan distributions and minimum participation and vesting standards. (Regardless of type, however, Keogh deductions are generally limited to the lesser of 15 percent of compensation or $15,000 for each self-employed person. And compensation for this purpose is limited to $200,000.)

Rangel would eliminate many of the distinctions between owner-employee and other Keogh plans. It would impose additional burdens on plans covering self-employed individuals who are not owner-employees ("little partner" plans). Under the change, the following rules would apply to such plans:

Vesting must be full and immediate for all participants (not just self-employed individuals).

All common-law employees must be covered by the plan after three years of service with the employer.

In the case of a profit-sharing plan, there must be a definite formula for determining contributions for common-law employees.

Little partners are precluded from making contributions to the plan greater than the amounts deductible.

Little partners are not permitted to receive plan distributions commencing before age 59½ (except in the case of disability) and must commence receiving plan distributions before age 70½. Distribution rules also specify the procedures to be used when the self-employed individual or his spouse dies before the total plan interest has been distributed.

As noted above, the bill would double the dollar limit on deductible contributions, from $15,000 a year to $30,000. The limit of 15 percent of compensation, if less than $30,000, would still apply. The $30,000 figure also would become the maximum limitation for deductible contributions to SEPs.

The proposed increase in the deductible limitations applies to taxable years beginning after 1983, while the additional restrictions on little partners apply to plan years ending after 1983. A company could elect to have the new rules apply one year earlier, if it wished.

What the bill accomplishes

The effect of the bill is to impose added restrictions on most little partners without offering any commensurate improvement in their situation. On the other hand, owner-employees suffer no new restrictions and many would be able to double the amount of their deductible contributions. The "tax equity" of this change is not readily apparent to non-Congressional observers.

Some firms could incur added costs in complying with requirements to change existing participation rules and vesting schedules, and to fix contribution formulas under profit-sharing plans. The costs of communicating there required changes to little partners could be an additional burden.

VI. APPLICATION OF H.R. 10 RULES TO "PERSONAL SERVICE CORPORATIONS"

H.R. 6410 would extend to shareholders of a narrowly defined list of "personal service corporations" the same limits and penalties that apply to owner-employees and other self-employed individuals under pension plans of unincorporated businesses. In effect, these corporations would be treated as sole proprietorships or partnerships for pension purposes; their retirement income plans would henceforth be subject to the special rules governing the design and operation of H.R. 10 (Keogh) plans.

What the "problem" is all about

Despite the periodic increases in contribution and deduction limits applicable to self-employed persons covered by Keogh plans, these limits continue to be far more restrictive than those applicable to qualified plans of corporations. Thus, there has been a strong incentive for small businesses to incorporate. The tendency to do so has been most noticeable among doctors, dentists and lawyers—in short, those firms that for years were prevented by legal and ethical standards from operating in a corporate form. Other small companies have incorporated as well, but some government officials view it as "unnatural" for members of certain professions to do so.

The IRS, in particular, has publicly deplored what it perceives as a raid on the Treasury by a group of already affluent individuals. But it has not been able to find a legally defensible way of denying to the major stockholders of a professional corporation the same pension entitlements that inure to stockholder employees of any other corporation. Nor, among professionals in general, has the IRS found a way of correcting the "excessive" deductions allowed to those who incorporate vis-a-vis their counterparts still operating as sole proprietors or partners.

The Rangel bill proposes to resolve this "inequity" by substituting yet another. The substitute focuses not on the type of organization of the business, but on the type of business being conducted.

H.R. 6410 would explicitly deny the advantages of the higher contribution and deduction limits under regular qualified plans to shareholders of any corporation whose principal business is providing services in the fields of health, law, engineering, architiecture, accounting, actuarial science, the performing arts, athletics or consulting. Conversely, it would leave untouched the sole owner of a corporation providing other (unnamed) services, or engaged in manufacturing, retail trade or any of a thousand different occupations. Neither would it affect professionals, such as doctors or lawyers, who work not for themselves, but for another employer whose principal business is other than health or law.

What are the consequences?

The primary target of this section of the Rangel bill—large shareholders in small professional service corporations—would find their opportunities for tax-favored retirement savings sharply reduced. So would the hundreds of small shareholders of large companies ofering services of the kind stipulated in the bill.

Companies in the service industry that are unaffected by these rules should not be unduly complacent. The "hit list" could be readily expanded by any Congress intent on revenue enhancement. The next logical targets are probably insurance companies, agents and brokers. Banking and financial service firms are also fair game, not to mention individuals who—regardless of their employer—are members of one of the professions singled out by Rangel.

It is ironic that, in a country lately characterized as having a service-based economy, efforts are now under way to weaken service businesses in their ability to attract and retain key employees. This has especially ominous implications for our balance of trade; according to a recent Kiplinger Letter, the U.S. exports over $60 billion in services each year. Much of this revenue comes from businesses that the Rangel bill specifically targets for "reform." One would have hoped that Congress, seeing the havoc wreaked on U.S. businesses operating abroad by the imposition of income tax on the compensation of U.S. expatriate employees, had learned its lesson.

Some observers see the effort to broaden the reach of Keogh plan limits as a first step to extending the same constraints to all corporate retirement plans. Advocates of this ultimate form of "pension equity" have been numerous in prior administrations. The result, or course, would be a victory for those social architects who believe that the best hope for an expanded Social Security system lies in deemphasizing the role of the private pension system.

Effective date

This law change would apply to years ending after 1983. The bill does not specify whether plan years or tax years are intended.

VII. KEY EMPLOYEES TAXED ON VALUE OF "DISCRIMINATORY FRINGE BENEFITS"

The Rangel Bill would include in the income of key employees the value of benefits provided to them under discriminatory "fringe benefit" plans. "Key employees" for this purpose include officers, employees with greater than 5 percent ownership interests in the employer and, subject to certain exclusions, most of the 15 percent highest-paid employees. "Fringe benefit plans" subject to the bill include group term life insurance, accident or health plans, group legal services plans, qualified transportation plans and education and dependent care assistance programs.

The nondiscrimination rules would apply both to a plan's eligibility provisions and to the type and amounts of benefits available. If the plan covers at least 70 percent of all employees, or 85 percent of those covered are non-key employees, or if the plan satisfies any classification rules established by regulation, the eligibility conditions for nondiscrimination are met. For this purpose, employees with less than three years' service, part-time and seasonal employees and members of union groups may be excluded.

Differences in the utilization of benefits by key employees and other employees would not be treated as discriminatory. And even if the plan were deemed discriminatory, this alone would not create an income tax liability for rank-and-file employees—only for the key employee group.

A special rule would permit group life insurance benefits to vary according to employee compensation. All other benefits would have to be uniform, regardless of pay.

Current law compared

Similar nondiscrimination rules apply now to self-insured accident or health plans, prepaid legal services plans, qualified transportation plans, educational assistance plans and dependent care assistance programs. No such rules apply to group term life insurance or to insured accident and health plans.

Under current law, all employees—including rank-and-file—are subject to tax on their benefits if a plan violates a nondiscrimination requirement.

Implications of the Rangel bill

In General.—A company maintaining a discriminatory "fringe benefit" plan would cause key employees to pay a penalty in the form of added income tax. The implications are otherwise not too serious: the plan itself would not be disqualified; the employer would lose no deductions, and employees other than key employees would incur no financial penalty. In short, a plan may be as discriminatory as a company chooses as long as it deems the extra tax liability to be an acceptable price.

This does not belie the inconvenience and administrative nuisance of determining which employees are "key" and which are not. The top 15 percent could be different in each plan, depending on its specific eligibility requirements. And at some companies, the top 15 percent will include thousands of employees. Determining the portion of total plan costs attributable to that group, and allocating it among them as additional taxable income, could be a formidable undertaking indeed.

Group Term Life Insurance.—Because employees already realize taxable income each year equal to the cost of their term life insurance coverage over $50,000, H.R. 6410 has a limited effect. A discriminatory plan—e.g., two times pay for all employees plus an additional one times pay for executives—would result in an extra tax for key employees based on only the first $50,000. The annual cost to such an employee, assuming a 50 percent marginal tax bracket, would be based on age, as follows:

Annual tax paid on $50,000 coverage

Age:	*Tax*
Under 30	$24
30 to 34	30
35 to 39	42
40 to 44	69
45 to 49	120
50 to 54	204
55 to 59	330
60 or more	489

There is one technical problem in maintaining an overtly discriminatory group life insurance plan. Unless those employees with extra coverage precisely match the "key employee" group, a key employee ineligible for the extra (discriminatory) amount would nonetheless owe tax on the employer cost of his total coverage, including the first $50,000.

Disability benefits.—The bill as written suggests that disability benefits programs—both short-term and long-term—could not provide benefits that are related to pay. The exception permitting pay-related benefits applies only to life insurance. Moreover, the nondiscrimination requirement suggests that the IRS might interpret the law not to permit integration of LTD plans with Social Security or other governmental benefits.

Medical plans.—"Discriminatory" insured medical plans are now exempt from special tax penalties. Rangel would remove the shelter; it would no longer matter whether the plan is insured or self-insured.

Retirees.—Because the bill seeks to prevent discrimination in favor of only key employees, it seems that discrimination in favor of "highly paid" retirees would continue to be permitted.

Flexible compensation.—The bill's provisions do not appear to disallow elections among different levels of benefits under flexible compensation programs. As long as the various options are available to all covered employees, discrimination will not result even if the high-paid tend to opt for the high-option (more costly) alternatives.

Effective date

These changes would apply to plan years ending after 1983.

VIII. LIMIT ON ESTATE TAX EXCLUSION FOR QUALIFIED PLAN DISTRIBUTIONS

The Rangel bill would limit the amount excluded from a decedent's gross estate tax rules to $500,000. The value of all distributions from qualified plans, tax-sheltered annuities and IRAs would be combined for this purpose.

How and what is changed

Under current law, distributions from qualified plans attributable to employer contributions are totally excludable from an employee's gross estate if paid in the form of an annuity. Annuity distributions from tax-sheltered annuity contracts and IRAs are also generally excludable. On the other hand, the value of lump sum distributions is includable if the recipient elects ten-year forward averaging of such distribution for income tax purposes.

Using the qualified plan example, here is the practical effect of the change:

Under current law, a surviving spouse receives a lump sum distribution includable in the decedent's gross estate. However, use of the marital deduction eliminates any tax consequence. If H.R. 6410 were enacted, the net effect is the same.

Under current law, a non-spouse beneficiary receives an amount includable in the gross estate. Estate tax may be payable. The same would be true even if the law is changed.

Under current law, a surviving spouse receives an amount totally excludable from the gross estate and there is no tax consequence. If the law is changed, only $500,000 would be excludable and the remainder would be includable; however, the tax consequence would be eliminated by use of the marital deduction. Thus, if H.R. 6410 is enacted, the net effect is the same.

Under current law, a non-spouse beneficiary receives an amount excludable from the gross estate—e.g., an annuity. If the law is changed, only $500,000 would be excludable and there woudl be a tax consequence for the remainder. This is the only circumstance under which the Rangel bill would increase estate tax liability.

Why all the fuss?

It seems unnecessary for Congress to enact a change in law that affects only non-spouse beneficiaries receiving otherwise exludable payments from these plan sources. Surely non-spouse members of a deceased emplyee's family are entitled to have the same protection as surviving spouses.

Nor is it clear why Congress would want to encumber the tax code with changes that have little or no net effect. Under the new qualified plan limits proposed by Rangel, the value of a survivor annuity will exceed $500,000 only in the rarest of cases.

Effective date

These changes would apply to estates of persons dying after 1982.

UNIGARD INSURANCE GROUP,
June 8, 1982.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: We believe H.R. 6410, the Pension Equity Tax Act of 1982 (PETA) introduced by Representative Charles B. Rangel, could cause private pension and other employer-sponsored benefit plans to suffer severe damage. For the most part, the bill is distinctly negative in tone and punitive in effect. It is another example of the government's continuing intervention in the private pension system and private welfare plans, something we thought Washington was trying to reduce. We especially want to comment on the following:

LIMITATIONS ON RETIREMENT PLAN BENEFITS

The current limits, adjusted for cost-of-living changes, are $45,475 for annual additions to defined contribution plans and $136,425 for annual pensions paid from defined benefit pension plans. PETA would (1) reduce these limits to $30,000 and $90,000, respectively, (2) eliminate any future cost-of-living increases in the limits, (3) reduce the $90,000 maximum for retirement before age 65 (currently age 55), and (4) prevent an employee reaching the new lower maximum in one type of plan from participating in any other qualified plan of the same employer.

The effect of these changes on the retirement security of higher level employees would be extremely onerous, especially when one considers inflation. In addition, required reductions in benefits for these employees quite possibly would result in corporations reducing benefits for all employees.

SOCIAL SECURITY INTEGRATION

The ability of qualified plans to integrate with Social Security is part of the foundation of the private pension system. That foundation would be badly eroded by PETA. An offset-integrated pension plan, which we have, could use in its formula only that portion of an employee's Social Security benefits attributable to FICA taxes actually paid on behalf of that employee by the employer sponsoring the plan. Most integrated plans would require extensive redesign not only to comply with this burdensome change but also to devise a new benefit formula so that pension costs are not extensively increased.

NONDISCRIMINATION IN WELFARE BENEFITS

PETA would require that vertually all employee benefit plans meet stringent tests for nondiscrimination in coverage and benefits. Except for group life insurance, all welfare plans would be required to provide employees uniform coverage regardless of pay. The bill suggests that not even disability income benefits, paid on account of accident or illness, could differentiate among employees on the basis of earnings. Who ever heard of not relating disability pay to earnings!!

We sincerely urge that H.R. 6410 not be passed.

Sincerely,

VELMA BERTILSON,
Assistant Vice President and Manager, Personnel Benefits.

UNITED TELECOMMUNICATIONS, INC.,
Kansas City, Mo., June 17, 1982.

(Attention: John Salmon, Chief Counsel.)

COMMITTEE ON WAYS AND MEANS,
House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: United Telecommunications, Inc. (United Telecom) and its subsidiary companies employ approximately 30,000 employees, substantially all of whom participate in a noncontributory defined benefit retirement plan that is integrated with Social Security.

We sincerely believe that the Pension Equity Act of 1982 (H.R. 6410), if enacted, would adversely impact the private sector benefit system in this country. It would cause a cutback in the present level of funding our existing pension plan; would preclude further improvements in the plan's benefit level; and would effectively make the establishment of a qualified savings plan or other similar plan for our employees an unwarrantedly cumbersome endeavor, if we were to adopt the same. In other words, H.R. 6410 would not be in the long-term best interests of United Telecom and its employees.

Our outside actuarial firm advises that reducing the maximum benefit limitation permitted under IRC Section 415 will cause a funding and benefit cutback for employees retiring at age 65 if they are as young as 25 years of age and earning at least $24,600 a year today. This essentially puts United Telecom in the position of only paying benefits up to the maximum level or of making up any shortfall through an unfunded pension plan.

Moreover, because the proposed legislation requires an actuarial reduction if maximum pension benefits are received before age 65, instead of before age 55, as under current law, the number of our employees adversely impacted will be further increased.

United Telecom has always believed an employee's retirement income should be derived from three sources: the United Telecom pension plan, Social Security, and personal savings. Over the last few years, United Telecom has been evaluating the establishment of a qualified savings or other similar plan in order to encourage and bolster personal savings. It appears that if the allowable ratio of 1.4 for combining defined benefit and defined contribution plan maximum limitations is reduced to 1.0, we would be effectively establishing a savings plan requiring employee contributions that would in turn reduce an employee's noncontributory pension plan benefit. Obviously, such a reduction would be a disincentive to personal savings through such a company-sponsored savings plan and would not be in the best interests of United Telecom's general employee body.

Finally, United Telecom strongly believes that in order to provide adequate retirement income to employees with diverse income levels, it is essential that its pension plan be integrated with Social Security. It is our understanding that in attempting to simplify very complex integration rules, H.R. 6410 could disadvantage certain low-paid individuals.

Furthermore, should a change in integration rules cause increased contributions to the United Telecom pension plan, United Telecom may be unable or totally unwilling to improve its pension formula from its current benefit level. Therefore, if due to cost constraints United Telecom is unable to provide adequate retirement benefits to its employees, it would be logical to assume such employees will in turn look to governmental programs, such as Social Security, for assistance.

With the current pressures already on the Social Security system, it seems incongruous to consider legislation that will not only stifle the expansion of retirement benefits by corporate sponsors, but place further large burdens upon governmental programs neither designed with such in mind nor consistent with public policy.

For the reasons above stated, United Telecom, on behalf of its employees, is opposed to passage of H.R. 6410.

Very truly yours,

JOHN F. DODD.

USAIR,
Washington, D.C., June 7, 1982.

Mr. JOHN SALMON,
Chief Counsel, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: I'm writing to comment on proposed House bill H.R. 6410. Enactment of this legislation will cause me problems and work a harsh penalty on thousands of America's commercial airline pilots. I serve as Plan Administrator for USAir's pension programs, one of which covers more than 1,300 pilots.

One section of the proposed legislation will lower the ERISA limit on defined benefits from an annual maximum now of over $136,000 to $90,000 and freeze the limit at that level. Then, the law will required that benefits which commence prior to age 65 will have the $90,000 limit further reduced according to acturial adjustments to be promulgated in regulations. This is likely to limit the benefits payable from the funds of a qualified defined benefit plan at age 60 to around $58,000 annually.

Under the Railway Labor Act and because of FAA regulations, USAir now retires its career captains from flying at age 60 with benefits that exceed $60,000 annually. I believe the labor union that negotiated these benefits would be surprised to learn that their elected representatives find the benefits now to be excessively generous and will attempt to "roll them back" by legislative fiat. Considering that Congress has not seen fit to offer Social Security benefits to Commercial Airline Pilots at age 60 when the FAA takes away their right to earn a livelihood at that time, this proposed action in H.R. 6410 would now take away their employers right to retire these skilled professionals at a reasonable percentage of the wages "society" determined they were worth just one day earlier.

At a minimum, the proposed legislation should provide an alternative age for freezing the maximum benefit for commercial airline pilots and should amend the Social Security law to make retirement benefits available to such individuals who have been forced to retire from their profession at age 60 by regulations issued by the F.A.A.

The problems I would have in explaining the impact of this legislation to our pilots, if passed in its present form, should be obvious. I hope it will not become necessary. Thank you for your consideration of these suggestions.

Sincerely,

Herbert L. Dyer, *Treasurer.*

New York, N.Y., *June 17, 1982.*

John Salmon, Esq.,
General Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: I would like to submit for the record and for consideration by the House Ways and Means Committee the following comments on H.R. 6410 relating to proposed changes which would affect the pension benefits of partners, self-employed individuals and employees of professional service corporations.

At present, self-employed individuals including partners of small and large partnerships are deprived of the right to provide for themselves through qualified plans reasonable pension benefits equal to those that can be provided for employees of corporations.

The disparity in benefit levels is substantial. Corporations can provide an annual retirement benefit of $136,425 in a defined benefit plan and make a maximum annual contribution of $45,475 to a defined contribution plan, subject to the 1.4 rule where benefits are provided under both types of plans. Partners and self-employed individuals were limited to contributions of $7,500 per annum to a defined contribution plan through 1981 and commencing in 1982, $15,000. While partners and self-employed individuals can instead receive a benefit under a defined benefit plan, the limitation of Section 401(j) of the Internal Revenue Code effectively limit the benefit of such a plan to the equivalent of an annual contribution of approximately $7,500.

There is no rational basis fot this discrimination against partners and self-employed individuals. As a result of this discrimination, many professionals have formed corporations so that these corporations could provide pension benefits for them as employees of the corporations. Contrary to the belief of some, qualified plans of professional corporations, including the plans of incorporated partners of professional partnerships, cannot discriminate with respect to either the employees of the professional corporation or the employees of related partnerships. Section 414(m) of the Internal Revenue Code, added to the tax law by Section 5(a) of Public Law 96-613, specifically provides that the test with respect to the discrimination of one professional service organization must be made with respect to employees of related service organizations.

H.R. 6410 would provide in Section 6 that any shareholder of a "personal service corporation" who is an employee of such corporation is to be treated as a self-employed individual for purposes of the rules relating to qualified plans. It is inequitable and discriminatory to single out personal service corporations for this treatment which would substantially reduce the pension benefits that could be provided for their professional employees. As indicated above, the same benefits that are provided for the professional employee-shareholders must be provided for employees of the professional corporation and any related service organization whether incorporated or not. There are no special reasons adherent to professional service corporations which should result in their being subjected to this discriminatory treatment. The incorporation of professionals has been motivated by the legitimate desire of professionals to provide reasonable pension benefits for themselves commensurate with benefits permitted for executives of corporations.

As an example, my firm, Weil, Gotshal & Manges, has had a defined benefit plan for its employees since 1969. Because of the limitation on benefits with respect to partners under existing law, the firm could not adopt this same plan for the benefit of our partners. Because of these limitations, several of my partners have recently incorporated. Those that have already adopted pension plans have adopted plans substantially identical to the plan provided for our employees since 1969. To put the discrimination against partners in perspective, my partners would not have incorporated if they would have been permitted to be included in the plan provided for our employees and to receive commensurate benefits.

I approve the move toward equality of self-employed plans with corporate plans which would be provided by the provisions of Section 5 of H.R. 6410 which increase the maximum deduction for partners and self-employed individuals from the present $15,000 limit to a new limit of $30,000. Unfortunately, other proposed changes in Section 5 would extend various restrictive rules presently applicable only to plans providing benefits for "owner-employees" (partners of self-employed individuals with a greater than 10 percent interest in profits or capital) to plans providing benefits for partners of partnerships regardless of whether any partner has a greater than 10 percent interest in profits or capital. There is no justification for imposing the owner-employee restrictions on qualified plans of large partnerships which have no partners that have a greater than 10 percent interest in profits or capital. These restrictions include (1) the requirement that all contributions on behalf of employees be 100 percent vested, (2) the requirement that in a profit sharing plan the formula for contributions be fixed, (3) the requirement that each employee having three or more years of service must participate in the plan, (4) the requirement that no benefits may be distributed to a partner prior to attaining the age of 59½ unless disabled, and (5) the requirement that if a partner dies his entire interest must be distributed within five years after his death or applied to the purchase of an immediate annuity for his beneficiary.

I have no objection if Congress, in its wisdom, believes that the foregoing rules should be imposed on all corporate plans. However, in the absence of such action, I strongly object to the extension of these rules to large partnerships which operate in exactly the same manner as many large corporations. Many partnerships, such as my own firm, have several hundred employees and there is no reason to treat the qualified plans of such partnerships any differently than the qualified plans of large corporations. Rather than impose additional restrictions on partnerships as provided by H.R. 6410, Congress should take this opportunity to eliminate the distinctions with respect to qualified plans among self-employed individuals, partnerships and corporations and provide for full equality in qualified plans for partnerships and self-employed individuals. There is no rational basis for the continued discrimination against partnerships and self-employed individuals with respect to the ability to provide adequate retirement benefits.

Very truly yours,

MARK A. VOGEL.

WATERFORD MEDICAL ASSOCIATES, P.C.,
Pontiac, Mich., June 8, 1982.

JOHN SALMON,
Chief Counsel, House Ways and Means Committee, Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: I have heard that the House Ways and Means Committee will hold a hearing on HR 6410, a bill proposed by Rep. Charles Rangel (D-NY). Among other things, I understand that this bill will reduce contributions to qualified pension and profit sharing plans. More specifically, this bill would:

(1) Reduce the maximum annual contribution per participant to defined contribution plans (profit sharing and/or money purchase pension plans) from the current level of $45,475 to $30,000;

(2) Reduce the maximum annual benefit per participant in defined benefit pension plans from the current level of $136,425 payable at age 55 to $90,000 payable at age 65;

(3) Stop the maximum contribution and benefit levels referred to in (1) and (2) above from increasing with the cost of living index;

(4) In addition to the reductions described in (1) and (2) above, significantly reduce the amount you can contribute when you have both defined contribution and defined benefit plans;

(5) Virtually eliminate loans from pension and profit sharing plans to key employees; and

(6) Place professional corporations under the more restrictive KEOGH (partnership and sole proprietorship) rules for purposes of participation and vesting.

I am personally completely opposed to this piece of legislation or anthing similar to it. I am voicing my opinion as a concerned American who is in complete opposition to this type of legislation. I certainly hope that my feelings and those of others who are as deeply concerned about this as I am will be listened to with an open ear by your committee when the hearings begin on HR. 6410. I would like to go on record as being completely opposed to this bill or to any concept related to this bill.

Very truly yours,

JOEL K. LEIB, D.O.

STATEMENT OF DALE SORGET, MANAGER, GOVERNMENT RELATIONS, WHIRLPOOL CORP.

Whirlpool Corporation is a leading manufacturer and marketer of major home appliances. Our total number of employees amounts to about 19,300 people. Of this number, approximately 5,100 are weekly and monthly salaried employees who participate in Whirlpool's long-standing pension and/or savings and profit sharing plans and who would be immediately affected by the Pension Equity Tax Act of 1982 (H.R. 6410). We are, therefore, vitally interested in proposals contained in H.R. 6410 that would, if enacted, adversely affect the company's pension and savings plans that are designed to provide for and preserve the financial integrity and well-being of our employees upon retirement.

Whirlpool is unalterably opposed to H.R. 6410. We believe that if this or similarly written legislation is enacted, it would adversely affect the company's long-standing plans for its employees, and could precipitate adverse economic consequences by halting the creation of more private pension and savings and profit sharing plans in the nation.

Following are Whirlpool's major objections to H.R. 6410:

1. Whirlpool offers two basic plans to its employees, both of which are 100-percent funded by the company: (a) pension plans that accrue to all company employees, and (b) a savings and profit sharing plan for all monthly salaried employees. Monthly salaried employees may elect to set aside 15 percent of their most recent annual salary in the savings portion of the savings and profit sharing plan. This amount is tax-deferred under present federal laws. Employees who choose not to participate in the savings portion of this plan receive their distribution in cash.

Approximately 1,425 (or about 50 percent) of eligible employees have chosen to participate in the savings portion of the savings and profit sharing plan. Through prudent investments, the balance in the savings fund accruing to the employees' accounts has grown substantially through the years. This financial source, coupled with pension fund payments, and supplemented with Social Security income, has in most cases provided a reasonable measure of financial self-reliance for our retirees.

Passage of H.R. 6410 would substantially weaken the benefits of this company program for a large number of our employees, not just the top paid executives being targeted by this bill. Because H.R. 6410 says that the maximum benefit for defined benefit plans cannot exceed the lesser of the fixed dollar limit or 100 percent of an employee's three-year average compensation, virtually all 1,425 of Whirlpool's employees who elect to participate in the company's savings and profit sharing plan would have considerably fewer dollars available in the fund upon retirement. Furthermore, with the combined plan limitation rule lowered from today's 1.4 to 1.0, an employer like Whirlpool, which has more than one defined contribution plan that generates a 15 percent annual addition, would not be allowed to have a defined benefit plan which provides a pension at age 65 in excess of 40 percent of an employee's three-year average compensation, regardless of the dollar limitation. At the same time, H.R. 6410 proposes a $90,000 annual limit on the amount a retiree may receive, and proposes limits on annual additions into the plan to $30,000.

We fail to see the logic of any bill that proposes to weaken the provisions of strong private sector pension and savings programs. By reducing benefits of private sector plans, H.R. 6410 is automatically placing greater burden and pressure on a Social Security system whose solvency is already in jeopardy.

2. Although H.R. 6410 is reportedly designed to restrict the payout of retirement benefits to high level executives (who, incidentally, are already limited by Employee Retirement Income Security Act (ERISA) provisions), its most damaging consequences would reach deeply into middle and lower level employee ranks. Approximately 765 (or about 27 percent) of Whirlpool's management employees have annual salaries above $32,000 and would begin to feel the effects of this legislation. By any basis of comparison, employees at this level of compensation should not be targeted for retirement benefit reductions. Several million employees throughout the U.S. could be penalized by this bill.

Because H.R. 6410 does not provide for automatic COLA increases in the wage base, virtually all private pension recipients could eventually fall subject to the bill's tax-deferred contribution limitations: monthly, weekly and hourly employees alike. This would portend even greater dependence on a weak Social Security system in the years ahead. These limitations would place undue restrictions on all employees who have been participating in these plans over a long number of years and who have relied upon the tax laws in existence throughout that period.

H.R. 6410 is discriminatory because it exempts government pension plans from coverage of the bill's provisions. As of 1980, the assets of all public pensions amounted to $284.3 billion. H.R. 6410 exempts these funds. Private funds, whose assets were $444.8 billion, would, however, be adversely affected. Although H.R. 6410 deserves to be defeated, we believe it would only be appropriate and fair to all U.S. citizens that Congressional and government employee pension plans be included under the same provisions of H.R. 6410. In the same vein, we encourage the bill's supporters to work for passage of a law to require all government personnel to participate in Social Security—to the same extent all private sector wage earners must participate. These added funds would, of course, help to shore up a federal system on which H.R. 6410 will place greater demands.

3. Since H.R. 6410 automatically defines all employees who participate in Section 401(k) plans as being "key employees," this bill would severely restrict or even practically eliminate loans from qualified savings and profit sharing plans to Whirlpool employees by treating such loans as taxable income. This would be a severe change of long-standing practice which plan participants have relied upon for many years. For example, the company's younger and lower paid employees, whose recourse to borrowing is often limited, would be severely restricted by this fall. Whirlpool's policy regarding employee loans from the savings and profit sharing fund is intentionally restricted and, to insure compliance with Internal Revenue Service guidelines, is adhered to on a consistent basis for all levels of management. Company employees who are plan participants may borrow only for home purchases (principal domicile), children's education, major medical expenses, or extraordinary expenses (reviewed on a case-by-case basis).

4. The effects of H.R. 6410 seem totally inconsistent with some major objectives Congress set when it enacted the ERISA law in 1974 and subsequent savings incentive legislation. Two of these objectives were to provide for the retirement needs of an increasing percentage of private sector employees and to promote the growth of pension plans. H.R. 6410 may likely frustrate the achievement of these goals. As the federal government reduces the incentives for participation in these plans, companies may elect to substantially reduce or eliminate these savings and profit sharing and pension plans. The long term effects of that action would create unprecedented pressure upon a Social Security System whose very solvency is being questioned by a growing number of American workers. Clearly, Social Security could not hope to replace the lost income of employees whose retirement benefits would be cut.

5. H.R. 6410 runs counter to the prevailing philosophy in government to promote personal savings for industrial expansion. Only one year ago, Congress passed various pieces of legislation in the Economic Recovery Tax Act of 1981 with the avowed purpose of encouraging the growth of personal savings. Its action was to increase a savings rate that had dipped to dangerously low levels compared to rates in other, more savings-conscious industrial nations. The benefits of these savings incentive plans are now beginning to show. More and more workers, for example, are beginning to invest in Individual Retirement Accounts. Even so, the U.S. savings rate of 5.2 percent (reported by the Deparment of Commerce) is three to four times below the rate for countries like Japan, West Germany and several other nations.

Based upon the personal consumption patterns of many Americans, it is plausible to assume that, if Congress limits the amount of tax-deferred funds that can be channeled into pension and savings and profit sharing plans, we can expect to see more consumption, more inflation and less savings for capital investment. While immediate consumption may have a specious appeal to stimulate recovery in today's economy, the long term consequences upon the nation's future pool of investment funds could be disastrous.

It is reported that private sector pension and savings plans now represent the single greatest source of investment capital in the nation. Any action by Congress to restrict this one bright source of investment capital would be an extraordinary example of bad public policy.

CONCLUSION

We believe that H.R. 6410, when evaluated in the broad social context that it demands, has few, if any, socially redeeming provisions. It offers no meaningful, constructive approach to stimulate economic recovery . . . to improve the financial well-being of millions of American's workers . . . or to generate sufficient funds to reduce a deficit budget.

Rather, it is a regressive bill in that it promises to penalize the savings plans of millions of Americans who are already justifiably concerned about a shaky Social Security System . . . and a bill that will weaken the paramount role pension and savings plans now serve in channeling vitally needed long term investment funds to a capital-starved economy.

No legislation like H.R. 6410 that carries such a large social and financial price tag to the nation at large should be seriously considered or voted upon only one month after introduction.

H.R. 6410 constitutes a complete reversal of what Congress hoped to achieve only last year when it enacted several pieces of legislation to stimulate personal savings. James Madison, in 1787, in Federalist paper number 62, wrote:

"It will be of little avail to the people that the laws are made by men of their own choice, if the laws . . . be repealed or revised before they are promulgated, or undergo such incessant change that no man who knows that the law is today can guess what it will be tomorrow."

We urge members of the Ways and Means Committee to vote against passage of H.R. 6410 or similarly written legislation.

WILLIAMS & BROOKE, P.C.,
Hartford, Conn. June 15, 1982.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: Williams & Brooke, P.C. is a law firm located in Hartford, Connecticut. Our firm represents several life insurance companies, insurance agencies and numerous small businesses. Our comments in this letter are made on behalf of our clients collectively, and not on behalf of any one particular client.

The effect of H.R. 6410 on qualified retirement plans and the businesses that establish or maintain them have been the subject of many comments submitted to you in writing, and given to the Committee in oral testimony on June 10, 1982. Our comments in this letter deal with Section 7 of H.R. 6410, the provision that would add antidiscrimination rules to fringe benefit programs.

We are opposed to the enactment of Section 7 of H.R. 6410 for the following reasons:

1. Section 7 of H.R. 6410 would result in greater expenditures by the Federal government.
2. Section 7 of H.R. 6410 would result in a minimal increase in tax revenues.
3. Section 7 of H.R. 6410 would result in less coverage for all employees in fringe benefit plans.
4. Section 7 of H.R. 6410 is unnecessary for group term life insurance plans as the area is already well regulated.
5. Section 7 of H.R. 6410 is unnecessary as the benefits provided under group term life insurance plans currently discriminate in favor of lower paid employees.

In the paragraphs that follow, we have provided a more detailed discussion of each of the preceding reasons for our opposition to Section 7 of H.R. 6410.

Section 7 of H.R. 6410 would result in greater expenditures by the Federal Government.

In any case where a new law is enacted by Congress, there is necessarily some additional expense on the part of the Federal government. These expenses would include the education of government employees associated with the affected area, and the cost to prepare and promulgate rulings and regulations interpreting the new law. While these additional costs to the Federal government should be considered whenever a new law is enacted, there are additional costs involved in this case that are of even greater magnitude.

The costs described in the preceding paragraph are the natural results of any new law. However, the provisions of Section 7 of H.R. 6410 would also require additional costs to monitor and administer the changes made by Section 7. That is, Section 7 of H.R. 6410 would impose formal nondiscrimination requirements on certain employee fringe benefits, such as group term life insurance plans. Currently, the requirements for such plans are relatively simple, and an employer may therefore establish or maintain such a plan with reasonable certainty that it will comply with the requirements of the Internal Revenue Code. However, if Section 7 of H.R. 6410 is enacted, the requirements would become much more complex. In that case, in order for an employer to have a reasonable degree of security that its plan would meet those requirements, a procedure for preapproval of the plan must be available.

There are currently formal nondiscrimination rules for qualified retirement plans. As a result of these rules, there are also a substantial number of Federal employees involved solely in the procedures to approve such plans. In the event that Section 7 of H.R. 6410 were enacted, there would also have to be a similar group of Federal employees to provide the same type of procedure for group term life insurance plans and other plans covered by Section 7.

In our view, the enactment of Section 7 of H.R. 6410 is contrary to public opinion and the objectives of both the Administration and the Congress. That is, Section 7 of H.R. 6410 would result in the creation of an additional Federal bureaucracy at a time when attempts are being made to reduce the cost of Federal government.

Section 7 of H.R. 6410 would result in a minimal increase in tax revenues

Under Section 7 of H.R. 6410, the cost of benefits provided to "key employees" in a discriminatory fringe benefit plan would be taxed as income to the "key employee." This is one source of potential tax revenue to the Federal government. That is, for those plans which are found to be discriminatory, the cost of the benefits for key employees would be taxed as additional income to the key employee.

In addition to the above described source of additional tax revenue, there would also be additional tax revenue if such employee fringe benefit plans were either terminated, reduced in their coverage, or not established when they otherwise might have been. In this case, the amounts that otherwise might have been expended for such fringe benefit plans may be paid as additional income to the employees involved. This represents an additional source of tax revenue to the Federal government.

For reasons that we will describe in the following paragraphs, it is our belief that the additional revenue described in the preceding two paragraphs will be minimal at best, and may in fact result in a decrease in overall Federal tax revenues.

The first source of additional tax revenues in the preceding paragraphs is where a plan is found to be discriminatory. However, logic would indicate that if a lesser amount of tax will be paid if the plan is made nondiscriminatory, then employers will, in general, strive to make their plans nondiscriminatory. Therefore, to anticipate additional tax revenues from this source is unjustifiable. In support of this position, we note that a very small percentage of all qualified retirement plans are found to be disqualified. Just as would happen with employee fringe benefit plans, employers have strived to make qualified plans adhere to the requirements for such plans, thus ensuring the favorable tax treatment that will result. For these reasons, we would not anticipate any significant Federal tax revenue from employee fringe benefit plans that were found to be discriminatory.

The second potential source of additional tax revenue due to the enactment of Section 7 of H.R. 6410 would result from employee fringe benefit plans that were either not established, terminated, or had reduced amounts of coverage. In this area as well, however, it is our view that the tax revenues to be gained are negligible or nonexistent. In many cases, monies that would otherwise be spent on such employee fringe benefit programs would instead be spent in other tax deductible ways. For example, if the requirements for group term life insurance plans become more stringent, employers may seek to include insurance in qualified retirement plans to a greater degree. Since the benefits under a qualified plan are tax favored, there would be no appreciable change in tax revenues if this were to occur. Other employers would instead of establishing a fringe benefit plan, pay the additional amounts to employees as compensation. Many employees would in turn take these new amounts of compensation and contribute to IRA accounts, again resulting in no appreciable change in tax revenues. Higher compensated employees would seek other tax sheltered investments to a greater degree to reduce or eliminate the tax incurred on the additional amounts of compensation.

For the reasons indicated above, it is our opinion that the enactment of Section 7 of H.R. 6410 will not result in any appreciable additional Federal tax revenues.

Section 7 of H.R. 6410 would result in less coverage for all employees in fringe benefit plans

As we described earlier in our letter, the enactment of Section 7 of H.R. 6410 would necessarily result in procedures to secure approval of such plans. Many employers will terminate or reduce the coverage under their existing plans or not establish new plans in view of these preapproval procedures and the expenses incurred from them. This result of H.R. 6410 is clearly exemplified by the number of plan terminations and the slower rate of new plan establishment for qualified plans after the enactment of Employee Retriement Income Security Act of 1974 (ERISA). Following the enactment of ERISA in 1974, there were a number of qualified plans that were terminated and many plans that would otherwise have been established were not solely because of the administrative burdens imposed by ERISA. It is anticipated that this same effect would occur if Section 7 of H.R. 6410 were enacted.

Section 7 of H.R. 6410 is unnecessary for group term life insurance plans as the area is already well regulated

For group term life insurance plans covering fewer than ten (10) employees, there are already in place rules established by regulation that require substantially all employees be covered. Further, these regulations also regulate the amount of coverage that may be provided to each employee, to ensure that disproportionate amounts of coverage are not provided. The current rules are easily applied, and have been in effect for a number of years. Therefore, any implication that there are currently no such rules in the group life insurance area is misleading. On the contrary, the current rules for under ten (10) life plans are well known, and far simpler than the rules proposed in Section 7 of HR 6410.

In addition to the rules for under ten (10) life plans established by regulation, there have been a series of rulings issued by the Internal Revenue Service with regard to group term life insurance plans in general. The IRS has been extremely active in regulating any potential abuses that may occur in this area, to the extent that the Treasury Department in its comments to the Committee has not recommended the enactment of Section 7 of HR 6410. Rather, those comments, which were presented by John E. Chapoton, Assistant Secretary of the Treasury, indicated that Treasury had certain areas under investigation, and that it was not in favor of Section 7 of HR 6410. In view of the Treasury's position, and the number of IRS rulings in the area, it appears that both the IRS and the Treasury are of the opinion that the area is already well regulated, and that there is no need for Section 7 of HR 6410 to cure any abuses.

Section 7 of H.R. 6410 is unnecessary as the benefits provided under group term life insurance plans currently discriminate in favor of lower paid employees

Under Section 79 of the Internal Revenue Service, the cost of the first $50,000 of group term life insurance coverage provided to employees is not taxable to the employee. However, the cost of coverage in excess of $50,000 is taxable to the employee in accordance with Treasury regulations. Under those regulations, the cost is determined under what is commonly known as Table I.

Because only the cost of group term insurance in excess of $50,000 is taxable to employees, the current structure is inherently discriminatory against higher paid employees. For example, consider a plan where coverage equals 2 times salary. For those individuals whose compensation is $25,000 or less, there is no additional income taxed to them as a result of the plan. However, for those employees whose earnings are in excess of $25,000, there is additional income, and additional income taxes as a result of the plan. In effect, the employee is taxed on the benefit provided in excess of $50,000 of coverage. Therefore, even under the most nondiscriminatory plan possible, i.e., a plan where coverage is based on a multiple of compensation, the current laws discriminate in favor of the lower paid employees and against higher compensated individuals.

We should also note that in theory the cost of group term life insurance in excess of $50,000 that is taxed to the individual is reflective of the actual cost of such coverage. However, due to more favorable mortality and interest experience over the years since the rates were initially established, the rates are now in many cases higher than the commercially available rates for such coverage. Therefore, not only is the current taxation of group term life insurance discriminatory against higher compensated employees but it is also exaggerated and unrealistic due to the higher rates of taxable income imposed.

SUMMARY

For the reasons described in the preceding paragraphs, it is our view that the enactment of Section 7 of HR 6410 will yield no appreciable benefits, and will also result in unnecessary expenses in both the public and the private sector.

Any questions on the above material may be submitted to the undersigned.

Thank you in advance for your consideration of our request.

Sincerely,

DONALD J. BROOKE.

Neurological Surgery,
Fort Collins, Colo., June 4, 1982.

John T. Salmon,
Committee on Ways and Means,
U.S. House of Representatives, Washington, D.C.

Hon. **Hank Brown,**
U.S. House of Representatives, Washington, D.C.

Dear Sirs: As a physician in Colorado and as a professional corporation, I am writing to you concerning Bill HR-6410, a bill which has been introduced by Charles Wrangler and I believe backed by Senator Dole.

It is my understanding that this bill limits the amount of contributions that I can contribute to my pension and profit sharing plan from $45,475 to $30,000 a year. It would also limit the amount of money that I could draw out of the pension plan at my retirement.

This bill would be bad on three points:

1. Pension profit sharing plan is the only way that I can reasonably save for my retirement. If this is restricted or limited, this affects my ability to save for my retirement years.
2. I think that this would severely restrict my ability to invest the pension and profit sharing money which goes back to American and private enterprise as investment capital.
3. I think it would make me feel more dependent on the Social Security system for retirement which I believe at this point is in shambles and probably at my age of 34 cannot be counted on for any reasonable means of retirement by the time I am 62 or 65.

Let me reiterate that I believe this bill would severely affect my current desire to save money and reinvest it in the future of America through my pension and profit sharing plan.

I sincerely hope you will do everything in your power to make sure that this bill does not pass through Congress.

Sincerely,

Timothy C. Wirt, M.D.

Witco Chemical Corp.,
New York, N.Y., June 28, 1982.

Mr. **John J. Salmon,**
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

Dear Mr. Salmon: Witco Chemical Corporation and its affiliates have approximately 8,000 full-time employees, all of whom participate in the company's pension plans and may also participate in the company's defined contribution plans. The proposals of H.R. 6410 regarding the reduction of Code Section 415 limitations have the potential of affecting as many as 65 percent of those employees, approximately 49 percent of whom are being paid under $31,000 annually. This result will occur with respect to Witco's plans primarily by reason of the reduction of the combined defined benefit and defined contribution fraction from 1.4 to 1.0, but also to some extent because of the reduced dollar limits of the Bill and the elimination of the cost of living adjustments to those dollar limits.

Witco thinks there are also serious detrimental aspects of this legislation concerning Loans to Plan Participants (401-K Plan).

For many years, Congress has encouraged employers to establish private retirement plans for employees by use of tax incentives to the employer. There is no assurance that an employer would be able to continue to provide those retirement benefits if tax benefits to the employer are eliminated in view of the costs of providing retirement benefits with after-tax dollars. We have traditionally sought to provide our employees with financial security during retirement through generous retirement benefit programs based more on perceived needs of our employees than on tax incentives which are available under the Code, although tax considerations have become a factor in plan design. Despite our concern for the welfare of our retired employees, if the proposals are enacted, we will have to reconsider seriously the cost effectiveness of our retirement plans as presently constituted and may well decide that it will be necessary to reduce benefits in the future.

An amendment to our plans to provide a reduction of benefits for possibly 65 percent of our staff will not only have a negative impact from an employee relations standpoint, but will also cause the affected employees to raise questions about the appropriateness of the legislation. To the extent that we do not adequately provide retirement benefits for our employees, it seems inevitable that those employees will become more dependent upon government sponsored programs. At a time when the programs of the public sector are strained financially, it is difficult to perceive the rationale of discouraging the private sector from offering those benefits. Certainly, the proposals are a disincentive for us to continue to provide the same retirement benefits we have offered in the past. If one considers "savings to be equal to investment" and economic consensus does perceive these two items to be equal; it is very confusing to see legislation being proposed which is a disincentive to savings and therefore a disincentive to investment. Such legislation retards investment and productivity rather than encouraging it.

The employees of Witco Chemical Corporation and other plan sponsors already bear a significant part of the burden of maintaining government retirement programs. In our opinion, it would be unjust to reduce the retirement benefits which might otherwise be earned by those employees while, at the same time, withhold funds from investment in order to obtain increased federal revenues of an indeterminate amount to be garnered at an uncertain time in the future. The emphasis of most retirement plans is to provide a secure retirement for employees and not to obtain a tax deduction for the plan sponsor. The proposals found in H.R. 6410 could result in reduction of those benefits, discourage plan sponsors from continuing to provide benefits, and place a greater burden upon government programs such as Social Security, while at the same time, withholding funds from the productive sectors of our economy, which, if properly invested, could support more vibrant long-term growth of our economy and society.

We sincerely hope that the House Ways and Means Committee will seek to obtain other statistical information from plan sponsors such as ourselves to determine the impact of the proposals on employees covered by defined benefit and defined contribution plans, particularly those employees who may be considered as lower paid.

In conclusion, we believe the enactment of legislation which will probably result in a reduction of benefits for such a significant number of our employees, particularly the lower paid, is inappropriate.

Very truly yours,

PAUL M. FEENEY,
Vice President and Treasurer.

THE WYATT CO.,
San Francisco, Calif., June 3, 1982.

Hon. DAN ROSTENKOWSKI,
Ways and Means Committee.

DEAR MR. ROSTENKOWSKI. I am writing to suggest improvements to H.R. 6410, the Pension Equity Tax Act of 1982.

The purpose of this bill appears two fold: to raise tax revenue and to eliminate what Congress determines are excessive benefits to highly compensated individuals.

The decision to eliminate "excesses" is a political issue I cannot support. If Congress decides to do this, however, I feel any proposed legislation should also: Disrupt the pension industry as little as possible, i.e., only those changes which affect the primary purposes of the bill should be made; Treat all highly compensated individuals equally, regardless of their job or profession; and Protect the benefits of lower paid individuals.

The following ideas are intended to achieve all of these objectives. They strive to build on existing laws, instead of making broad sweeping changes, like using a hammer to remodel a room instead of destroying the old room with a wrecking ball and throwing up a shack in its place.

Thank you for your consideration.

Sincerely,

PETER H. SORENSEN, *Consultant.*

SUGGESTED CHANGES TO H.R. 6410

Section 2. Overall limits

1. Benefit and contribution limits should be indexed at the same rate as federal income tax brackets.

No indexation is unfair to younger workers. For example, at 6 percent inflation, a 40 year old worker making $20,000 today would be making almost $90,000 at 65.

Thus, in 25 years, the maximum permissible limits would be only 20 percent to 25 percent of todays limits, and most workers would be affected.

2. In addition to an annual defined benefit limitation, deductions for small Plans (e.g. 25 or fewer participants) should be limited to the required deposit based on the UP 1984, 6 percent actuarial table.

This had two advantages. Currently, actuaries are encouraged to use lower earning assumptions than may be reasonable so that clients may contribute larger amounts. With a fixed assumption, this could not happen. Actuaries could use whatever assumptions they feel are reasonable to determine the required deposit, but the deduction would be limited to the amount determined using the fixed assumptions. Secondly, the IRS would be able to audit the determination of the defined benefit calculation much more easily.

Section 3. Loans

The proposed law is overly restrictive and should be modified by either the following:

a. Limit participant loans to 20 percent of the value of Plan assets as of the most recent valuation date, or

b. Prohibit loans to participants serving as a Plan trustee or in any other fiduciary capacity.

The credit markets are hard hit and greater demands should not be placed on them. The intent of this provision should be to prevent loans which are in fact nontaxable distributions to participants. The proposed law would result in the elimination of most Plan loan provisions. Profit sharing loans for example, have provided an excellent way for employees to buy into a Company, and many hardships have been remedied through viable loans to participants.

Alternative a. is in keeping with ERISA's diversification requirements. Alternative b. prevents transactions which are not at arm's length. Both ideas would significantly curtail current loans abuses.

Section 4. Integration

1. The proposed law should not reduce the defined contribution integration percentage from 7 percent, but should require that at least 50 percent of the employer contribution be used to provide benefits based on all compensation as a condition of being able to provide benefits only on compensation in excess of the taxable wage base. Even in a Plan which provides for contributions of 7 percent of pay in excess of the Social Security Wage Base, the spendable income ratio is large for lower paid than higher paid employees. The attached schedules in appendix A illustrate this. Integration should be used as an incentive for Plan sponsors to provide benefits for lower paid workers.

2. Instead of totally new defined benefit integration rules the existing rules set forth in Revenue Ruling 71-446 should be changed and simplified as follows:

a. For excess benefit plans, eliminate the flat benefit rules and allow only unit benefit integration which: Provides for an excess benefit accrual maximum of 1 per year of service (regardless of the compensation base used): and Require that the excess benefit percentage does not exceed the basic benefit percentage.

b. For offset plans: Change the rule to a maximum annual offset of 2.2 percent of the Social Security benefit per year of service (based on the Social Security Act in effect at the time the benefit is determined); and Require that the offset percentage not exceed ⅔ of the benefit formula percentage.

c. Simplify the adjustments to be made for different retirement dates and benefit forms as follows: Unreduced benefit starting before age 65: a 1/15 reduction for each year retiring early between ages 60 and 65 and a ⅓ reduction for each year retiring early between ages 55 and 60; and Normal form of benefit accrual is other than a single life annuity:

Benefit accrual form

	Percent reduction
Joint and survivor annuity with:	
50 percent continuance to beneficiary	90
Greater than 50 percent continuance	80
Period certain and life annuity where:	
Certain period is 10 years or less	90
Certain period is greater than 10	80
Installment or cash refund	90
Other (subject to adjustment by IRS Commissioner)	80
Cost of living adjustment provided: No adjustment	NA

	Percent reduction
Preretirement death benefit is provided:	
If equal to acturial reserve or less	90
If equal to greater than acturial reserve	80
Preretirement disability benefit is provided:	
If acturially reduced—no reduction	NA
If no acturial reduction	90
Employee contributions are required: No adjustment, but employee contributions must be made on an integrated basis	NA

Sections 5 and 6. Speical rules for self-employeds and professional service corporations

1. The proposed law should not focus on professional service corporations, but on small corporations (for example, less than 25 employees).

Small corporations, not professional service corporations per se, are in a position to take special benefit from laws pertaining to qualified plans. A company such as Bechtel should not have different laws apply to it than to other major employers as they often compete for the same employees. Small brokerage companies, incorporated sales representatives and others should not be able to continue their plans without much change where others, who are arbitrarily entitled "professional service corporations", would have to comply with drastic changes.

2. Small (or service) employers should be differentiated from other employers only when a compelling reason to do so exists. The following rules should apply to qualified plans of:

a. *All* employers regardless of business or size:

Defined Contribution plans should be limited to 25 percent of pay;

Defined benefit limitations (IRC Section 415(b) should not exceed 100 percent of pay or $90,000 reduced by 1/20 for each year of service less than 20, measured from the later of the Plans original effective date or an employees date of hire;

Participation and vesting requirements for all qualified Plans should be governed by IRC Sections 410 and 411 and

Do not require bank trustees, but set tough standards for individual trustees such as:

(i) Require a complete annual trustees report or a CPA audit report be filed along with the annual government report; (ii) Provide harsh penalties for any material misrepresentation of information; and (iii) Give the IRS power to require a CPA audit or even a bank trustee in cases where trustee reports are found to be inaccurate or incomplete.

(NOTE: No reason exists for this proposed legislation to become known as the Bankers Full Employment act of 1982.)

b. Only small employers:

Distribution rules for 10 percent owner-employees are needed as "separation from service" is different for this group.

Allow compensation in excess of $100,000 to be included only if contributions on behalf of non owner employees averages at least 10 percent pay.

APPENDIX A—SPENDABLE INCOME ANALYSIS

A comparison of spendable income before and after retirement which is adjusted for taxes and job-related expenses provides a truer picture of benefit adequacy than one based on gross income. Retired people are treated differently tax-wise because they receive double tax exemptions starting at age 65, their social security benefits which start as early as age 62 are not taxed, and they are usually in lower tax brackets. These factors have the effect of increasing the percentage of a retired person's gross income which is available to spend.

Our analysis compares the income for a person retiring at age 60 after 25 years of service and includes the social security benefit which will not begin until age 62. Single retirement exemptions are assumed even though double exemptions will begin at age 65. More specifically, our analysis is built on the following definitions and assumptions.

DEFINITIONS

1. "Spendable income before retirement" equals gross income minus federal income tax, state income tax, social security tax, estimated work-related expenses and personal savings.

2. "Spendable income after retirement" equals Retirement Plan benefits, Profit Sharing Plan benefits and primary social security minus federal and state income

taxes. No benefit from employee contributions, personal savings or spouse's Social Security is assumed.

3. "Suspendable income ratio" equals "spendable income after retirement" divided by "spendable income before retirement".

TAX ASSUMPTIONS

1. Federal Income Tax—Based on new tax law rates which will take effect for 1984 and future years. Asumes $1,000 personal exemption for employees and pensioners. Deductions assumed to equal standard deduction or, if greater, 15 percent of gross income.

2. State Income Tax—Assumed to equal 20 percent of federal income tax.

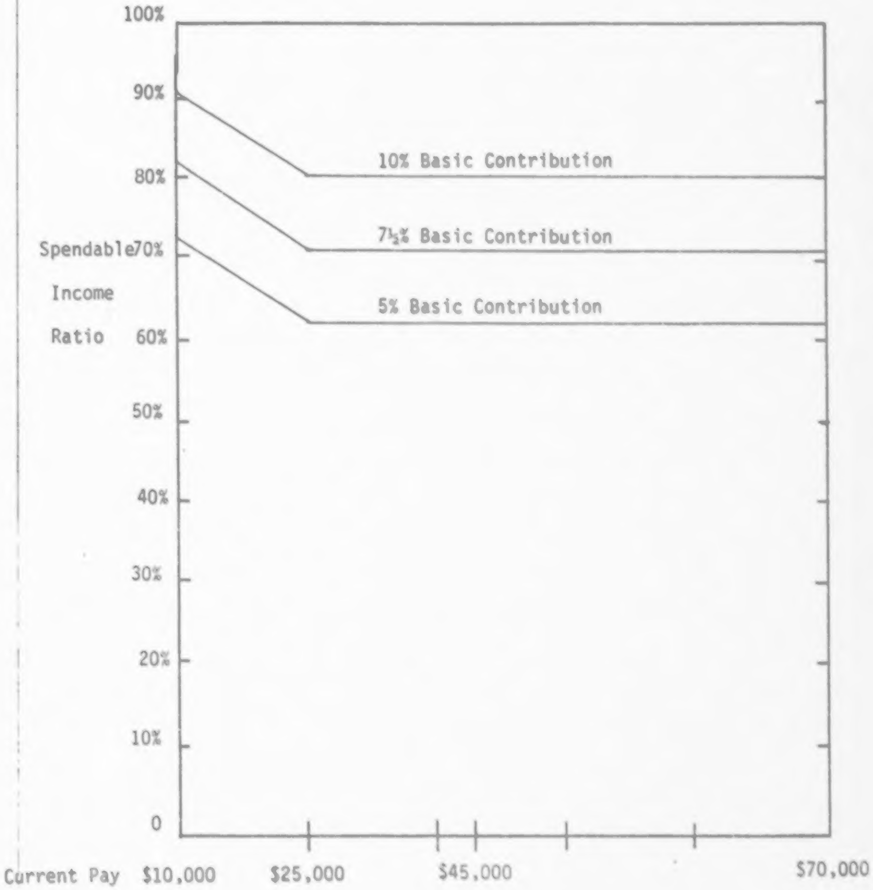
3. Social Security Tax—6.65 percent of taxable income up to $35,900 (the assumed 1984 wage base).

EXPENSE ASSUMPTION

Work-related expenses, voluntary plan contributions and pesonal savings, etc. assumed to be 10 percent of gross earnings.

Spendable Income Analysis for Various Basic Allocation Contribution Levels

Each line on the graph represents the spendable pension income (compared to spendable working income) from Social Security, a 7% annual excess contribution and an annual basic contribution as indicated.



PROFIT-SHARING ASSUMPTIONS

1. Employees are assumed to have started in PSRP on 1-1-76. The rate of increase and Plan contributions through 1980 have been assumed to be:

[In percent]

	Salary increase	Plan contribution	Plan earnings
1976	7	5	....
1977	8	6	8½
1978	8	7	8½
1979	8	8½	9
1980	10	8	10.4

2. Future Profit Sharing Contributions: Basic allocation assumed to be 5 percent, 7½ percent or 10 percent of Plan compensation as indicated; excess allocation assumed to be 7 percent of compensation in excess of the social security taxable wage base for the year. ($29,700 in 1981)

3. Future annual investment return on Profit Sharing Account Balances is 8½ percent per annum.

4. Each $100 of account balance at age 60 is assumed to provide a single life annuity of $10.94.

5. Annual Salary Increase—8 percent per annum.

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